IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

Petitioners,

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; H. ISAIAH SMITH and ROSS B. THOMAS, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

JOINT BRIEF OF RESPONDENTS EDGAR B. SIMS, AUDITOR AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, AND H. ISAIAH SMITH AND ROSS B. THOMAS, WEST VIRGINIA STATE COURT RECEIVERS.

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A. The case at bar is governed by the decision of this Court in the *Marine Harbor* Case, and the rules of law therein decided should be applied herein 25

B. Congress in enacting the Investment Company Act of 1940 intended that deposits made with State officials by face-amount certificate companies prior to January 1, 1941, should in the event of insolvency be retained by them, and the trust liens created by State statute should not be set aside; and Congress recognized the validity of, and legislated concerning, insolvency proceedings of such companies when instituted in proceedings other than under Chapter X, and permitted a very limited and strictly defined intervention therein by S. E. C. 35

Intent of Congress as Expressed in Committee Hearings on Act 35

Congress strictly defined and delimited intervention by the S. E. C. in insolvency proceedings of investment companies such as Fidelity, and enacted specific provisions for such proceedings when instituted other than under Chapter X 40

C. Securities were deposited in trust with States or other officials by Fidelity as required by valid State laws, for the benefit and protection of the purchasers and holders of Fidelity contracts in those States, and such securities so deposited should not now be taken from those States or State officials, and the trust lien thereby created

APPENDIX

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ARTICLES:

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OPINIONS BELOW

The opinion of the District Court is reported in 42 F. Supp. 973 (S. D. W. Va.) and is contained in the record (R. 176); the unanimous opinion of the Circuit Court of Appeals is reported in 129 F. (2d) 442, and is contained in the record (R. 238).

JURISDICTION

The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, and Section 24(c) of the Bankruptcy Act.

STATUTES INVOLVED*

United States Statutes

The following sections of Chapter X of the Bankruptcy Act: Sec. 130(7), 11 U. S. C. A. 530; Sec. 141, 11 U. S. C. A. 541; Sec. 144, 11 U. S. C. A. 544; Sec. 146, 11 U. S. C. A. 546, Parts (3) and (4).

West Virginia Statutes

Code of West Virginia; Ch.__, Art.__, Sec.__: 12-5-2; 33-2-45; 33-9-3; 33-9-10.

Constitutional Provisions Involved

Eleventh Amendment to the Constitution of the United States.

STATEMENT OF THE CASE

Foreword

The petitioners herein are Fidelity Assurance Association, a West Virginia corporation, hereinafter called the Debtor or Fidelity, and Central Trust Company, of Charleston, West Virginia, called the Trustee. The Securities and Exchange Commission, one of the respondents herein, which seeks reversal of the judgment below, is referred to as the S. E. C.

There are seven respondents in this case† who filed controversial answers to the Debtor's petition in the District Court, and joint and several appeals in the Circuit

*In the Appendix hereto, Parts I and II, are set out the United States and West Virginia statutes and constitutional provisions which are herein involved, or discussed in this brief, except those statutes which have been printed in the Appendix to petitioners' brief, to which reference is made.

†See R. 287-288 for official designation and 42 F. Supp., at 976, for their official representation.

Court of Appeals; five of them will be referred to herein as the Wisconsin, Iowa, Missouri, Maryland and Tennessee respondents.

This brief is filed jointly on behalf of Edgar B. Sims, Auditor and ex officio Insurance Commissioner of the State of West Virginia, and H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, hereinafter referred to jointly as the West Virginia respondents, and separately, as the Auditor of West Virginia and the West Virginia Receivers or State Court Receivers.

Four briefs will be filed by the respondents, who have divided the legal points among themselves; therefore each brief will not set out all questions in issue, but only those which will be discussed therein; so it will be necessary for the Court, if it will, to consider all briefs filed by the respondents as one composite brief.

In the brief of the Wisconsin respondents will be a full "Statement of the Case"; this and other briefs of respondents will set forth such additional "Statement" as may be necessary to a proper presentation of the points therein argued.†

How the Case Arose

Fidelity Assurance Association, formerly Fidelity Investment Company, a West Virginia corporation, with its principal office in Wheeling, West Virginia, from 1911 through 1940 sold installment investment annuity contracts, recently called face-amount-certificates. By reason of State laws so requiring, deposits of securities were

†R.____ designates the page of the printed record; Ex. p.____ refers to the original exhibits, which are not printed; Michie's 1937 Code of West Virginia will be designated Code — — —, being respectively, chapter, article and section. *All emphasized places in this brief are by counsel.*

made in fifteen States, in trust with State officials, for the protection of contract holders in each of those States. Fidelity being unable to comply with the provisions of the Investment Company Act of 1940, and having been in financial difficulties for some years, and being unable to obtain new capital, the Attorney General of West Virginia, on behalf of Auditor Edgar B. Sims, on April 11, 1941, instituted statutory proceedings in a West Virginia State Court against Fidelity as an insolvent. Fidelity's assets were then valued at approximately $2,500,000 less than the liabilities (R. 181), and no equity remained for the stockholders (R. 196, 259). Officials in other States having a deposit of Fidelity then instituted similar proceedings in their States. (See Appendix, Part III.) While those proceedings were progressing, some of Fidelity's former officers, on June 6, 1941, instituted Chapter X proceedings in the United States District Court for the Southern District of West Virginia, which approved the petition and appointed a Trustee.

Auditor Sims, officials of other States, and groups of contract holders contested the good faith in the filing of the petition, and the jurisdiction of the District Court. After a lengthy hearing, all questions were decided against them, and an appeal was taken to the United States Circuit Court of Appeals for the Fourth Circuit. The decision of the District Court was reversed and the Debtor's petition was ordered dismissed, the Court holding that Fidelity had become an insurance company before the petition was filed, that the company should be liquidated, and that prior proceedings were pending in the State Courts which would best subserve the interests of the contract holders in such liquidation. Debtor and its Trustee petitioned this Court for a writ of certiorari, which was granted. The facts upon which the arguments made in this brief will be based are stated below.

Background of State Deposits Made by Fidelity

The Legislature of West Virginia in 1911 first enacted legislation licensing the selling of annuities in West Virginia by companies other than life insurance companies, after a compliance with certain conditions precedent. Shortly thereafter, Fidelity was incorporated in West Virginia and, after a compliance with the statutory requirements and conditions, obtained a license and engaged in the business of selling installment annuity contracts.

The most important feature of this legislation was the requirement that such a company, as a condition precedent to receiving a license to do business in the State, deposit with the Insurance Commissioner, "in trust, for the benefit of its contract holders in this State," approved securities in the amount of $10,000.00.

This legislation was amended from time to time so that by 1933, when respondent Edgar B. Sims was elected and took office as Auditor of West Virginia, and by statute (Code 33-1-1) became ex officio Insurance Commissioner of West Virginia, the pertinent part of the depository law with regard to annuity companies (Code 33-9-3) required that companies selling installment annuities "deposit with the state treasurer (in accordance with Article 5, Chapter 12 of this Code), in trust, for the benefit of its contract holders," approved securities in the amount of $100,000.00, and in addition thereto an amount equal to its cash liabilities to its contract holders; and when "the laws of any other state" require a deposit "equal or greater in amount for the benefit of contract holders in such state," upon filing a certificate from the proper official of that State with the Insurance Commissioner of West Virginia, no deposit was required in West Virginia for the benefit of contract holders in that State; and "when the laws of another State require such deposit less in amount," then a certificate showing the amount de-

posited must be filed and a deposit is required in West Virginia "which together with the deposit made in such other state shall make up the total amount required by this state to be deposited * * * and such contract holders in such other state shall not be entitled to the benefit of the securities deposited with the treasurer of this State under this article, except so much of such deposit as may be made to complete the total amount required by this article where the law of any other state requires a lesser amount." On January 1, 1941, there was approximately $10,000,000 in securities on deposit with the State of West Virginia for the protection of Fidelity's contract holders, by virtue of this statute.

Statutory deposit requirements were enacted by other States sometimes as a part of their "Blue Sky" laws, and sometimes as special laws to regulate companies of this type (see Ex. 6, pp. 125 and 177, Report of S. E. C. to Congress); and at the institution of these proceedings, in thirty-six States of the United States (see Table B, infra) a deposit was required of either Fidelity or Investors Syndicate, the only other substantial company doing a similar business to that of Fidelity,* and deposits had been made in fourteen of those States by Fidelity.[1] The required deposits were in an amount not less than 100% of cash liability to the contract holders, except in

*Together these two companies did 98% of said business. See Ex. 6, pp. 3, 128-9, Report of S. E. C. to Congress, Appendix, Part VIII.

[1]In Delaware, Illinois, Iowa, Kansas, Maryland, Ohio, Pennsylvania, Tennessee, Virginia and Wisconsin a deposit was required by the statute. In Kansas the requirement for a deposit was not reenacted into their securities laws after 1929. The Ohio deposit law was passed on April 21, 1939, and beginning March 1, 1940, was to be retroactive. The Illinois deposit law was passed July 7, 1931, and at a later date it was made retroactive. In Indiana there was a deposit law prior to April 1, 1935, and there was no depository requirement between that date and April 1, 1939. After that date, Indiana (as did Alabama, Kentucky and Missouri, through their Securities Department) required Fidelity to enter into a trust indenture, with a named trustee, usually a local bank, and to deposit securities under said trust agreement to be equal at all times to not less than 100% of its cash liability to its contract holders in the state.

Pennsylvania and Virginia, where fixed amounts of $100,000.00 and $25,000.00, respectively, were required to be deposited. On January 1, 1941, there was on deposit in these fourteen States approximately $10,000,000.

All such deposit statutes and required trust indentures specifically provided or stated in substance that the required deposit of securities was to be *in trust, for the benefit of contract holders or purchasers* in the particular State requiring such a deposit; most of the deposit laws and all of the trust indentures provided a proceeding for liquidation and distribution in event of insolvency, usually in a State Court, and under the supervision of State officials, advised by their Attorney Generals.[2]

In West Virginia, the supervising authority for Fidelity and its deposit was the Auditor and ex officio Insurance Commissioner, who upon default or insolvency (Code 33-9-10) could revoke the license of the company, and thereupon "the deposit, or a sufficient amount of the same, shall remain under his authority and control" until the total liability of all the contracts is redeemed or settled.

It was further provided (Code 33-2-45) that the Insurance Commissioner, when any company under his supervision became insolvent, could file a bill in the Circuit

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[2]In the Appendix, Part III, is set forth a brief summary of the deposit laws and requirements of each of the fifteen States wherein Fidelity made a deposit, and as well a brief resume of the proceedings pending therein on June 6, 1941, at which time the Chapter X proceedings were instituted; also, a table (Appendix, Part VIII) prepared by the S. E. C. showing the thirty-one States having a deposit of over $48,000,000.00 from Investors Syndicate.

Appendix D of the S. E. C. brief purports to set out in full all the laws and trust indentures of the fifteen depository States. However, it is incomplete, since it leaves out some sections and parts of sections of the State laws and trust indentures, believed by respondents to be pertinent. Briefs of respondents will set out all the applicable laws of their own States, and the summary in Appendix, Part III, hereof attempts to give a correct summary of the laws and indentures of every depository state.

Court of Kanawha County (the seat of the State government) for the administering of the assets of such company as an insolvent, and for the purpose of taking possession of its property in the State and the distribution of its assets among those entitled thereto, according to their respective rights.

Fidelity's contracts contained a provision that the reserve funds were to be invested in approved securities and "deposited in trust in acordance with the laws of West Virginia."

Institution of State Court Proceedings

As set out fully in the Wisconsin brief, Fidelity's financial difficulties began at least as early as the depression years, and new capital was sought for Fidelity for several years prior to 1941. None was ever procured, none has since been promised, and there is no pending promise for new capital to be forthcoming in these proceedings.

Fidelity was unable to comply with the requirements of the Investment Company Act of 1940 (passed in August, 1940), and was thereby prohibited from further engaging in the annuity business after January 1, 1941. It failed to procure new capital, and failed in attempted voluntary reorganization plans. On December 31, 1940, it converted itself into an insurance company, but being unable to comply with West Virginia laws to continue in such business, it shortly became apparent that Court proceedings were necessary. On March 25th, Auditor Sims requested the company to advise him of its choice between Federal and State Court proceedings (Ex. 94, set out in Appendix, Part V). On April 4, 1941, all of its licenses having been revoked, Fidelity was ordered by Auditor Sims to freeze all of its accounts and the West

Virginia deposit remained under the authority and control of the Auditor until the total liabilities were redeemed or settled (Code 33-9-10). Thereupon, Fidelity, at a two-day session of its board of directors (April 7th and 8th), resolved and expressed its preference in favor of State Court proceedings (R. 408).

On April 11, 1941, the statutory proceedings authorized to be brought by the Insurance Commissioner (when any company under his supervision becomes insolvent) in the Circuit Court of Kanawha County were instituted by the Attorney General of West Virginia on behalf of the Auditor (R. 61, 82). This Court had full equity jurisdiction (R. 1206), the exercise of which was also prayed for in the bill of complaint (Ex. 21, p. 16). Officials of all other States holding a Fidelity deposit were notified by Auditor Sims by telegraph, and they immediately took proper action and brought proper proceedings under the laws of their States (R. 62).

In the West Virginia proceedings receivers were appointed to collect the *undeposited* assets of the Debtor (Ex. 70), and those receivers are respondents in the case at bar. Fidelity appeared and raised no objection and filed no answer.

The State Court Receivers took charge of the home office of Fidelity, and collected the undeposited assets of Fidelity. In the two months period of their operation, they had prepared most of the financial and other data necessary to a study of the situation.

Institution of Chapter X Proceedings

On June 3, 1941, a purported corporate meeting of Fidelity was held in Pittsburgh (this meeting later being held by the District Court to have been invalid [R. 189]), at which a resolution was passed, purporting to authorize the filing of a petition under Chapter X.

Pursuant to this purported authority, on June 6, 1941, Debtor's petition was filed in the United States District Court for the Southern District of West Virginia. Immediately thereafter Central Trust Company of Charleston, West Virginia, was appointed as the disinterested trustee and attorneys for it were appointed by the Court (R. 1); a turn-over order was at once entered against all State authorities, and all State Court Receivers, including the respondents in the case at bar and any others who had in their custody, possession or control any assets which had been deposited by Fidelity, or which belonged to it. (R. 2). This order was amplified and strengthened on June 10, 1941 (R. 11). All of these proceedings were *ex parte* and without notice to these respondents (R. 176).

The West Virginia State Court Receivers, under written protest (R. 80), turned over the undeposited assets of Fidelity which they had collected, together with an escrow fund comprising payments made by contract holders after Auditor Sims' freezing of accounts on April 4th.

The Auditor of West Virginia, who had not turned over the West Virginia deposit to the State Court Receivers (such deposit having remained in the custody of the State Treasurer and under the authority and control of the Auditor as required by Code 33-9-10), together with the officials of the other fourteen depository States, refused to comply with the turn-over order. Auditor Sims, through the Attorney General of West Virginia, and the State Court Receivers by their attorneys, applied to the District Court for a stay of the turn-over order; and, upon refusal thereof, made application to the Circuit Court of Appeals for a stay, pending an appeal from the order. Thereafter, by agreement of counsel, the then *status quo* of the deposited securities was continued pending a hearing in the District Court. Auditor Sims and the State Court Receivers intervened in the District Court as par-

ties, by permission of the Court, and filed controversial answers to the Debtor's petition (R. 58, 79) challenging the jurisdiction of the District Court to entertain the Chapter X proceedings, and challenging the good faith in the filing of Debtor's petition, and appealed to the Circuit Court of Appeals from the turn-over order.

While there had been no objections raised by contract holders to the State Court proceedings (R. 483), groups of contract holders from West Virginia, Tennessee, Iowa, Michigan and Ohio appeared in the District Court, by counsel (R. 287-288), and objected to the Chapter X proceedings, and most of them filed controversial answers to the Debtor's petition.

Thereafter, a majority of the States which held a deposit of Fidelity entered an appearance in the District Court on behalf of their proper State officials, represented in most part by their attorney generals, and filed controversial answers to the Debtor's petition (R. 287-288).

The S. E. C. intervened as a party in the proceedings and undertook to sustain the validity thereof and the jurisdiction of the District Court. The Trustee, through its attorneys, took part in the proceedings for the same purpose.

A hearing was had upon the issues raised by the petition and answers from August 5, 1941, intermittently until October 10, 1941.

On August 9, 1941, during the hearing, the turn-over order against the depository States was amended *nunc pro tunc* to June 6th into a "freezing" order which enjoined the officials of the depository States from doing anything with the deposited securities except hold them (R. 102), but the Trustee was not required to return to the West Virginia State Court Receivers the funds they had

turned over to the Trustee. Maryland, Tennessee and West Virginia respondents filed motions to vacate this order (R. 124, 128, 168, 170, 172).

The West Virginia respondents sought a writ of prohibition in the Circuit Court of Appeals against this "freezing" order, which on October 21, 1941, was argued jointly with their appeal from the turn-over order. The principal issue raised by the appeal was whether the Eleventh Amendment to the Constitution of the United States was a bar to taking the deposited assets from the State of West Virginia and causing them to be turned over to the Trustee. The Circuit Court of Appeals, being informed during oral argument, of the hearing currently being held below, and perceiving that later a more complete record would be before it in an appeal upon the merits, and that the rights of other depository States who were not parties to the appeal would of necessity have to be adjudicated, thereupon refused the writ of prohibition and dismissed the appeal without prejudice. *Sims* v. *Central Trust Company*, 123 F. (2d) 89.

Solvency of Fidelity

While there are many financial statements of Fidelity in evidence, none adequately presents a correct picture of the net assets and net liabilities of Fidelity as of April 10, 1941, its last day in active business. Therefore, counsel has compiled Table A below from original and unprinted Exhibits Nos. 35, 47 and 48.

Exhibit 48 correctly states the liabilities as of April 10, 1941, both net reserve and net cash surrender (that is, after deduction of loans to contract holders). However, the figures given in Ex. 48 for the total at market value as of June 6, 1941, of all securities deposited with the States ($20,056,680.27) and the free securities ($556,467.51), although used by Judge Soper in the opinion be-

low (R. 242), are incorrect. The sum total of those two amounts is exactly the same as shown in Ex. 35 for total value as of June 6, 1941, of all the deposited securities at *market value*, plus the value of all mortgages at *book value*. Therefore, the figures given in Ex. 48 are not market value, but include all the mortgages at book value.

Attached to Ex. 35 is a breakdown of the mortgages into classes. In view of the testimony as to the value of the mortgages and real estate (Original transcript of evidence, pages 1248, 1250-53, 1258-60, 1331-46, and 1353-56, only part of which is in the printed record at R. 612-15 and 619-20), and the statement in S. E. C. Appendix C to brief, page 7s. 2(b), counsel has arbitrarily set the value of the real estate, furniture and fixtures, and all mortgages except F. H. A.'s at 60% of the stated book value.

Exhibit 47 gives the gross assets of Fidelity as of April 10, 1941, hence the necessity for restatement to show only the net assets.

There are other small liabilities, and perhaps other small amounts of assets, but counsel believe Table A presents a reasonably correct and adequate picture of the situation as it then existed.

The deficit of Fidelity on April 10, 1941, was therefore $3,192,666.55, and the percentage of solvency was 86.97% based upon net assets and net reserves.

TABLE A

SUMMARY OF ASSETS AND LIABILITIES, APRIL 10, 1941

Fidelity Assurance Association

Condensed from Original Exhibits 35, 47, 48

ASSETS[a]

Market value of all securities		$19,075,549.58
Cash		570,245.73
Accrued interest on Bonds, Mortgages, etc.		322,466.46
Miscellaneous		19,598.35
Net value life insurance		2,994.24
Mortgages, F. H. A.		592,594.95
	(Book Value)	
Real Estate	($438,105.11)	[b]262,863.07
Mortgages, Home Office Building	(450,000.00)	[b]270,000.00
Mortgages, Other Real Estate	(256,500.00)	[b]153,900.00
Furniture and Fixtures	(80,648.34)	[b]48,389.00
Total		$21,318,601.38

(a) All figures are from Ex. 47, except the breakdown of mortgages is attached to Ex. 35.

(b) Arbitrarily stated at 60% of book value, in view of testimony and Court's comments thereon, R. 612 to 615 and 619-620; also statement in Appendix C to S. E. C. brief, p. 7s. 2(b). Total amount thereby deducted $457,842.04.

LIABILITIES—NET RESERVE BASIS

Net Reserve Liability to Contract Holders	[c]$24,221,651.37
Net Deficiency U. S. Income Tax Claim	[d]289,616.56
Total	$24,511,267.93

DEFICIT—NET RESERVE BASIS

Total	$ 3,192,666.55

PER CENT OF SOLVENCY

Per cent of solvency net reserve basis	86.97%

[c] Ex. 48.
[d] As of May 27, 1941 (R. 1221).

Liquidity of Deposited Securities

On pages 96 and [illegible] of Exhibit 6, the report made to Congress by the S. E. C. concerning Fidelity, it is stated: "The Association has followed a settled policy of investing its funds almost entirely in marketable securities, about 90% of which have consisted of bonds and notes. Investments in stock have consisted principally of preferred stocks and have been, in the main, too small to be of any importance." On the same pages, as set forth in the Appendix, Part VIII herein, is Table 26, showing the percentage by years of investments by Fidelity in various categories. The percentage of investment in real estate, as shown by the table, has always been less than 1% of the assets.

In a letter to the contract holders dated July 3, 1941, the Trustee herein stated that Fidelity's property "is almost entirely in the form of liquid assets composed of stocks, bonds and other forms of securities" (R. 45).

At the present time, Fidelity is even more liquid, as many securities, some real estate, and some mortgages, have been converted to cash.

Specific Data on Contract Holders and Deposits

The numerous exhibits introduced in evidence, which contain voluminous detailed financial data, are not printed in the record herein, but are before the Court in their original form. Counsel have taken the liberty of transposing and shortening much that is therein contained into the following tables, with accompanying explanations.

A composite picture of the location of the contract holders by States, showing the net reserve and net cash liability due them, and the location of the deposited securities, together with their market value, and the per-

centage of market value to cash liability, is set out hereunder in Table B.[a]

Fidelity listed the contract holders on its books by States, according to their residence, such information being furnished by the contract holder. Deposits in the States were made, changed, substituted and withdrawn accordingly, as the contract holder gave his residence or change of residence (R. 758, 759). Therefore the statement in Appendix A, p. 2, footnote, S. E. C. brief, is not correct. For that reason, the table is in the form below.

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[a]This table is compiled principally from unprinted Ex. No. 34 and No. 48, and the market value of securities contains mortgages at book value as heretofore explained. See also Appendix, Part IX.

TABLE B
Fidelity Assurance Association

1	State 2	No. of Contracts having reserve value or monthly payments being paid currently on 4/4/41 3	Total No. of Contracts 4	Net Reserve Liability April 10, 1941 5	Net Cash Liability April 10, 1941 6	Securities Deposited Market Value June 6, 1941 7	Percentage of Market Value to Cash Liability 8
FD	Alabama	81	172	$ 32,267.31	$ 31,346.71	$ 32,555.16	103%
	Arizona	24	22	10,613.46	10,191.92		
	Arkansas	16	18	8,629.80	8,221.58		
D	California	228	236	174,940.15	169,577.35		
D	Colorado	25	30	18,576.99	17,909.03		
D	Connecticut	175	255	119,650.18	116,276.09		
	District of Columbia	1,658	2,644	982,833.44	952,502.25		
FD	Delaware	582	875	300,074.88	290,175.36	293,790.63	101%
D	Florida	119	154	100,987.41	97,946.02		
D	Georgia	254	508	163,021.69	159,164.28		
	Idaho	2	1	1,287.11	1,263.00		
FD	*Illinois	8,051	12,209	4,368,348.52	4,225,790.75	3,759,894.00	89%
FD	**Indiana	846	1,293	398,336.17	386,173.45	162,863.44	42%
FD	Iowa	54	84	35,332.03	34,478.27	45,082.50	130%
FD	Kansas	254	405	111,530.90	108,784.89	85,337.50	76%
FD	Kentucky	328	662	95,376.98	92,690.42	86,712.50	93%
D	Louisiana	301	375	42,934.29	40,941.77		
	Maine	6	5	2,577.16	2,484.50		
FD	Maryland	1,152	2,080	508,163.70	492,552.24	470,806.25	95%

	Montana	4	7	5,166.49	5,111.50		
D	Nebraska	24	20	7,882.08	7,661.27		
D	Nevada	1	3	317.95	312.50		
D	New Hampshire	9	12	9,312.83	9,151.84		
D	New Jersey	536	777	294,381.20	285,356.15		
	New Mexico	11	11	9,686.28	9,371.06		
D	New York	1,049	1,456	690,448.27	669,824.67		
D	North Carolina	117	183	82,995.68	80,592.13		
D	North Dakota	9	10	37,394.11	36,487.35		
FD	Ohio	6,059	14,807	2,439,364.17	2,360,418.70	509,573.44	21%
	Oklahoma	97	148	108,793.10	105,815.64		
D	Oregon	8	11	4,323.01	4,137.24		
FD	Pennsylvania	8,794	14,663	4,816,175.07	4,668,582.25	232,591.57	5%
	Rhode Island	10	14	6,822.86	6,647.71		
	South Carolina	256	351	42,152.14	41,130.62		
D	South Dakota	11	11	6,869.07	6,785.12		
FD	Tennessee	557	1,188	206,879.70	200,504.97	196,574.38	98%
D	Texas	89	84	39,152.19	37,829.08		
D	Utah	3	3	2,020.48	1,944.00		
	Vermont	6	9	3,723.17	3,564.50		
FD	Virginia	1,406	2,443	572,585.26	557,809.12	27,703.13	5%
D	Washington	41	41	35,646.49	34,650.60		
FD	West Virginia	4,947	8,260	2,256,147.34	2,181,681.75	10,674,696.08	489%
FD	Wisconsin	6,595	12,112	2,408,301.57	2,342,978.73	2,619,399.07	111%
D	Wyoming	6	8	5,783.00	5,679.79		
	Foreign Countries	107	116	74,982.34	72,811.33		
	TOTAL ALL STATES	50,201	87,999	24,221,651.36	23,475,668.67	120,056,680.26	85.4%
	*Illinois, issued before 7/7/31	1,820	3,219	983,117.48	927,051.05		
	*Illinois, issued after 7/7/31	6,231	8,990	3,385,171.04	3,298,739.70		
	**Indiana, issued before 4/1/35	200	614	116,615.51	111,974.93		
	**Indiana, issued between 4/1/35 and 4/1/39	446	679	263,298.69	256,326.23		
	**Indiana, issued after 4/1/39	200	200	18,421.97	17,872.29		

†—Includes mortgages at book value as explained for table A.

Explanation of Table B

In column 1, the "D" indicates a State with a depository law and which holds deposits of Fidelity or Investors Syndicate, the "FD" indicating Fidelity deposits.

Column 4 gives the total number of contracts, including those with no cash surrender or reserve value, but having a re-date privilege.*

Column 3 includes contracts upon which payments were currently being made, but an aggregate amount had not been paid sufficient to create, in some cases a reserve value, and in other cases a cash surrender value. It lists only the number of contracts and not contract holders, some of whom owned more than one.

Mr. McNulty, Secretary of the Debtor (R. 407), testified there were 22,000 to 25,000 actively paying contract holders on April 4, 1941 (R. 407). In addition, there were some fully paid-up contracts and some matured contracts.

Therefore, the number of contract holders financially interested varies between 22,000 minimum and 50,000 maximum.

In column 5 and 6 the net reserve and net cash liability is shown, which are those values after deducting the loans and accrued interest thereon.

The peculiarities of the Illinois and Indiana depository statutes are set forth in the Appendix, Part III, and the reason for the divisions of their deposits made in the foot-note.

Table C

This table is a summary of an arrangement into appropriate groups of the States and figures shown in Table B, with percentages calculated.

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*The re-date privilege is one whereby the contract may be given a new issuance date after it falls into arrears, with prior payments credited on the new certificate. The privilege is, practically speaking, perpetual. (Ex. 6, p. 110).

TABLE C
Break-down of Table B into Groups and Percentages
Summary for All States

STATES*	No.	No. of Contracts having reserve or monthly payments being paid currently on 4/6/41	Percent of Total	Net Cash Liability April 10, 1941	Percent of Total	Market Value Securities Deposited June 6, 1941	Percent of Total	Percentage of Market Value to Cash Liability
Non-Depository								
Less than 100 Contracts	22	521	1%	$ 404,145.01	1.7%			
Between 100 & 500 Contracts	9	1,841	3.6%	955,276.73	4.1%			
Over 500 Contracts	4	6,401	12.9%	3,355,290.39	14.3%			
Total Non-Depository	35	8,763	17.5%	4,714,712.13	20.1%			
West Virginia		4,947	9.8%			10,674,696.08	53.22%	489%
Total Looking Primarily to West Virginia Deposit	36	13,710	27.3%	6,896,393.88	29.4%	$10,674,696.08	53.22%	
Total Probable Claim Over Against W. Va. Deposit	5	17,359	34.4%	8,081,768.48	34.4%	1,016,069.08	5.1%	12.6%
Total Claim Against W. Va. Deposit	41	31,069	61.7%	14,978,162.36	63.8%	11,690,765.16	58.3%	78%
Total Probably No Claim Against W. Va. Fund	9	19,132	38.3%	8,497,506.31	36.2%	8,365,915.11	41.7%	98.5%
TOTAL ALL STATES	50	50,201	100%	23,475,668.67		20,056,680.27	100%	85.436%

*A further break-down of this summary into the individual States in each group is in the Appendix Part IX. The District of Columbia and Foreign Countries are each designated as a State.

QUESTION PRESENTED

The issue discussed in this brief is whether a corporation which sold installment annuity contracts pursuant to State laws especially enacted to regulate such corporations, and whose only substantial assets are securities deposited (as required by those State laws) with States or State officials *in trust* for the purchasers in each such State, and whose liabilities to its contract holders exceed its total assets, including such statutory deposits, may force State officials charged under such State laws with possession, administration, and in the event of insolvency, liquidation and distribution of the proceeds, of such deposited securities, into proceedings under Chapter X of the Bankruptcy Act, when there are then pending prior statutory and general equity State proceedings, instituted by those State officials, which are designed to safeguard and protect the rights of contract holders; and in such Chapter X proceedings take possession and control of the deposited securities from these States or State officials, and nullify or set aside the trust liens of the contract holders, created by the State statutes.

SUMMARY OF ARGUMENT

Briefs of other respondents will discuss and argue the question of whether Fidelity was an insurance company; whether it can or should be rehabilitated as an annuity or "face-amount certificate" company, or in any other line of business; if liquidation must ensue, whether a slow and orderly one is a reorganization within the purview of Chapter X; and whether there was good faith as defined in Section 146(3) of Chapter X in the filing of the petition. These issues will not be discussed hereinunder, except incidentally.

The West Virginia respondents will endeavor to show the Court that the Debtor's petition was not filed in good

faith as defined in Section 146(4) of Chapter X, in that there were then pending in State Courts, particularly in the Circuit Court of Kanawha County, West Virginia, prior proceedings which would best subserve the interests of Fidelity's contract holders, its only creditors.

In arguing this issue, these respondents will contend that the case at bar is governed by the decision of this Court in the *Marine Harbor* case; that Congress evinced and expressed the intention that in the event of insolvency the deposits should remain with and be administered by the State officials with whom those deposits were made; that there is no necessity for intervention by the S. E. C., and a lack of Congressional direction that it should intervene other than in the limited manner provided by Congress; that the deposits should not be taken from the possession of the State officials, and the trust liens created by the State depository laws, in favor of the contract holders in each State, should neither be nullified nor set aside; that the deposits were made with sovereign States or State officials who, because of the Eleventh Amendment, are not subject to suit, order or injunction by the District Court; that the deposit laws of each State must be interpreted by the State Courts thereof, which are better fitted so to do than is the Federal District Court to do it for them; and that these State officials represented by their Attorney Generals, and acting under the guidance of their respective State Courts, have not been shown not to be as able as the Federal Trustee to liquidate the deposits, and properly to distribute the proceeds thereof.

These respondents in this brief will argue fully one point, and will raise but not argue other points, which were issues raised in the District Court (R. 186-187) and in the Circuit Court of Appeals below, but were not discussed or decided in the opinion below. However, it is believed that this is permissible, and that any ground raised below,

which will tend to sustain, not overthrow, the judgment below, may be herein urged in support thereof.[5]

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[5] *Langnes* v. *Green*, 282 U. S. 531, at 535, 75 L. Ed 520;
Story Parchment Co. v. *Patterson Parchment Paper Co.*, 282 U. S. 555, 75 L. Ed. 534;
LeTulle v. *Scofield*, 308 U. S. 415, 84 L. Ed. 355;
Ryeman v. *U. S.*, 312 U. S. 405, 85 L. Ed. 917;
Public Service Commission of Puerto Rico v. *Havemeyer*, 290 U. S. 506, 80 L. Ed. 357.

ARGUMENT

I

THE DEBTOR'S PETITION SHOULD BE DISMISSED BECAUSE IT WAS NOT FILED IN GOOD FAITH AS DEFINED IN SECTION 130 (7) AND SECTION 146(4) OF CHAPTER X OF THE BANKRUPTCY ACT, IT NOT BEING SHOWN THAT THE PRIOR PROCEEDINGS PENDING IN STATE COURTS, PARTICULARLY IN THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA, WOULD NOT BEST SUBSERVE THE INTERESTS OF CONTRACT HOLDERS; SUCH PRIOR PROCEEDINGS HAVING BEEN INSTITUTED IN STATE COURTS BY OR ON BEHALF OF STATE AUTHORITIES HOLDING AS TRUSTEES SECURITIES DEPOSITED BY FIDELITY; PURSUANT TO VALID AND APPLICABLE STATE LAWS, FOR THE BENEFIT OF ITS CONTRACT HOLDERS IN EACH SUCH STATE.

A

The case at bar is governed by the decision of this Court in the Marine Harbor Case, and the rules of law therein decided should be applied herein.

In the case of *Marine Harbor Properties, Inc.*, v. *Manufacturer's Trust Company*, decided November 9, 1942, 11 U. S. Law Week 4020, 87 L. Ed. (Adv.) 73, Debtor's sole asset was a building located in New York, the value of which was admittedly less than the first mortgage on it. There were also junior mortgages, as well as unsecured debts. The mortgage had been purchased by a mortgage guaranty company, and participating certificates sold to

the public, and later the guaranty company became insolvent. Special New York legislation, called the Shackno Act, was enacted to deal with such insolvencies, and under that Act a trustee had been appointed and was acting in State Court proceedings. Four months after the trustee instituted a foreclosure action for the benefit of the first mortgage holders, the debtor instituted Chapter X proceedings.

The question in issue in the *Marine Harbor* case is the same as that with which we are here concerned, namely, should the Debtor's petition under Chapter X be dismissed under Section 130(7) and Section 146(4) because of prior proceedings pending in State Court?

In the *Marine Harbor* case the property involved was real estate; in the instant case the property is securities. In the former case a mortgage was placed on the real estate and the general public, by reason of having purchased certificates of participation, became the equitable owners thereof; and in the instant case, by virtue of the contract entered into with the purchasers of its contracts, the Debtor contracted to deposit reserve funds "in trust in accordance with the law of the State of West Virginia." (See Statement and Appendix, Part I.) Fourteen other States, by statute or trust indenture, required a similar deposit to be made in each such State, also in trust for the benefit of contract owners or purchasers in each such State.

In both cases the debtor had been in financial difficulties for a number of years; in the instant case at least since 1932. In both cases the debtor had unsuccessfully tried every logical and legitimate way of getting out of its financial difficulties, particularly by obtaining new capital. In the instant case the evidence shows that the Debtor for more than three years scoured the financial centers of the country in an attempt to interest new capital in the

enterprise, wholly without success. In the *Marine Harbor* case there was an intimation of possible new capital to be forthcoming upon reorganization; in the instant case there is positive evidence that there can be and will be no new capital available from any source (R. 260).

In both instances the value of the property is less than the liens upon it. In the *Marine Harbor* case it was less than the first lien; in the instant case there is only one lien, that is a trust lien for the benefit of contract holders, and upon a reserve liability basis (Table A in Statement) the company is only 86.97% solvent.

In both instances State legislation was especially enacted to deal with the particular circumstances. (Ex. 6, S. E. C. Report to Congress, pp. 125 and 127.) In New York the Shackno Act and other co-related legislation was passed to deal with insolvent mortgage guaranty companies. In West Virginia and other States, securities laws were enacted regulating companies selling annuities on the installment plan, requiring deposits from them, and providing proceedings for liquidation upon insolvency. (See Summary in Appendix, Part III.)

In the *Marine Harbor* case, because the value of the property was less than the first lien thereon, there was a necessity of dealing only with those first lienors, under the absolute priorities doctrine of *Northern Pacific R. Co.* v. *Boyd*, 228 U. S. 482, 57 L. Ed. 931, and *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 84 L. Ed. 110. In the instant case only the contract holders, all of whom are trust beneficiaries or secured creditors, need be dealt with, because the evidence discloses conclusively (R. 181), and both the District Court and Circuit Court of Appeals have so held, that there is no equity remaining in the assets for the stockholders (R. 196, 259), and it is admitted by petitioners herein (Brief, p. 40).

In both cases, before application was made to the Federal Courts there had been other proceedings. In the *Marine Harbor* case there were voluntary efforts at adjustment between the trustee of the mortgage and the debtor; there were Shackno Act proceedings in which the debtor took part; and then a mortgage foreclosure proceeding, which would have wiped out the debtor's entire interests, and those of the junior lienors.

In the case at bar, Fidelity tried all possible voluntary means of rehabilitation, including attempts to obtain new capital, *and finally* a conversion into a life insurance company. The S. E. C. had thoroughly investigated it and had presented its findings in a printed document to Congress (Ex. 6), and Congress had enacted the Investment Company Act of 1940 for the future regulation of such companies, and Fidelity was unable to continue in the annuity business under that Act.

As set out in the Statement, on April 4, 1941, the Auditor revoked Fidelity's license, retained the deposited securities (Code 33-9-10), and on April 11, 1941, caused his statutory suit to be instituted by the Attorney General in the State Court provided by statute (33-2-45).

The other depository States, by their proper officials, instituted proper proceedings under their laws.

All of these proceedings progressed satisfactorily, and apparently met with the approval of the contract holders, for at least there was no substantial objection thereto (R. 483), until a dissatisfied group of officers and stockholders of the company, held a purported corporate meeting on June 3, 1941, in Pittsburgh (held invalid by the District Court [R. 189]), and authorized the institution of the instant proceedings, for the apparent purpose of obtaining some equity or benefit for themselves, although as stockholders they had no equity remaining. (R. 196, 259).

Again the similarity to the *Marine Harbor* case is noted, in that those who there initiated the proceedings under Chapter X in debtor's behalf, apparently so did hoping to obtain some benefits thereby.

After the proceedings herein were instituted under Chapter X, the various State officials who were trustees of the deposited funds for the benefit of contract holders intervened and objected to the Chapter X proceedings, as well as groups of contract holders from West Virginia, Tennessee, Iowa, Missouri and Ohio (R. 287, 288).

After the affairs of the company had been fully aired by the hearing in the Chapter X proceedings, and it was judicially determined that the Debtor was insolvent in the bankruptcy sense, it was entirely apparent that the company could not be rehabilitated, and the need for prompt liquidation was seen (R. 259). This is apparently admitted by the S. E. C. brief filed herein (Brief, p. 47).

These respondents contend that liquidation should *promptly* ensue and the prior pending State Court proceedings are proper and adequate therefor.

The decision of the *Marine Harbor* case is exactly applicable to the situation here. There is positive evidence that the company is insolvent in the bankruptcy sense. There is entire lack of evidence that any new capital can be produced. It is admitted that the stockholders have no remaining interest or equity (Petitioners' Brief, p. 40). There are no junior interests in this case. Nothing remains under the "full priority rule of the *Boyd* case" but permitting the contract holders to realize upon their security.

Again like the *Marine Harbor* case, "much emphasis is placed on numerous safeguards contained in Chapter X." Again it can be said that these considerations might be relevant and persuasive "if this was the case of the usual

reorganization proceeding dealing with more than one class of securities under the older procedures which Chapter X was designed to improve and supplant"; or those safeguards might be given some consideration if the desired result was rehabilitation instead of liquidation.

However, there is only one class of creditors, that is the contract holders (*in re Stoddard*, 242 N. Y. 148, 151 N. E. 159), each and every one of whom, under the West Virginia law and the laws of the other fourteen depository States, is not only a secured creditor, but a *cestui que trust* or beneficial owner of the securities deposited in trust with the State of West Virginia or with the State in which that contract owner resides.

Therefore, in the case at bar, as in the *Marine Harbor* case, there is no need to determine whether the salutary safeguards of Chapter X exist in the pending State Court proceedings. Particularly is this true since liquidation and distribution are the only actions herein sought, or contemplated.

We request the Court particularly to note that no contract holder in any State, who must look primarily to the West Virginia deposit for his protection, has instituted any action in any State, or has made any objection or taken any Court action, in either his own State or within the State of West Virginia, to the proceedings carried on in the West Virginia Courts and by the Auditor of West Virginia; nor have the officials of any such States.

Mr. McNulty, Secretary of Fidelity, testified however, that forty to fifty per cent. of the contract holders who wrote to the West Virginia Receivers shortly after their appointment, even at that early stage, wanted cash immediately; that is, they desired an immediate liquidation and return of such money as was due them. (R. 320, 330).

After the Federal proceedings were instituted, the evidence shows that a mass meeting of contract holders was held in the City of Wheeling, West Virginia, where the home office of the company is located, and where naturally a large number of its contracts were sold; that the purpose of this mass meeting was to take proper steps to object to the proceedings instituted in the United States Court for the Southern District of West Virginia, and to demand that liquidation promptly ensue (R. 398, 402, Ex. B, C).

The proceedings instituted in the various States with reference to the securities deposited there, are in purpose and effect a foreclosure proceedure upon those deposits, and in nearly every instance are actually liquidation proceedings; and in each depository State there is ample legal machinery, either set up in the depository law, the securities law, or the general or equity law, whereby the securities deposited with the States can be therein liquidated and proper distribution made of the funds to those rightfully entitled thereto. As shown in Appendix Part III, by virtue of either the State statute, or by action in the proceedings, and before institution of the Chapter X proceedings, the legal title to the deposited securities, had become vested in the State or State official acting as trustee for the benefit of the contract holders in Alabama, Maryland, Iowa, Wisconsin and West Virginia.

Again the similarity to the *Marine Harbor* case is noted, because in that case there remained nothing for the trustee in State Court to do but sell the security and distribute the proceeds thereof, which could be done in the State Court in which the matter was pending, and proceedings for which had been started. In our instant case the same situation exists.

In the *Marine Harbor* case this Court held:

> "In view of the burden on a petitioner to make the showing required by Section 130(7) and Section 146(4), the Bankruptcy Court is not warranted in assuming, without more, that a State foreclosure proceeding instituted for and on behalf of the first mortgage creditors exclusively is inadequate, measured by Chapter X standards, to protect their interests. The contrary course would result in Chapter X making greater inroads on prior proceedings than Section 130(7) and Section 146 (4) indicate was the purpose."

Those words are directly applicable to the case at bar, particularly since the affirmance of the decision of the Court below is requested not only by the State officials, respondents herein, who are acting as trustees for the contract holders, but also by officials of other States wherein a deposit was made for the benefit of contract holders, who are acting as trustees in behalf of the contract holders of their respective States. These State officials are not respondents herein, but in a brief *amici curiae* adopted the position of these respondents and requested the same relief.

This Court specifically held: "Every petition under Chapter X must state, *inter alia*, 'the specific facts showing the need for relief under this chapter.' Section 130(7)," and further, "Congress in effect directed the bankruptcy courts not to approve petitions under Ch. X in such cases unless it appeared that the interest of creditors and stockholders would not be best subserved in the prior proceedings. And it put the burden on the petitioner to make that showing." An examination of the Debtor's petition shows that in paragraph III the Debtor stated that it engaged in the annuity business until December 31, 1940, when the Investment Company

Act of 1940 went into operation, "which Act so increased the reserve requirements on the part of Debtor to contract holders that Debtor found it impossible to comply with the provisions of said Act," (R. 5).

The Debtor neglected to state that the Investment Company Act (Sec. 28[a] [1]) provides that each such company must have a clear capital of fifty thousand dollars if organized and continuously operated prior to March 15, 1940, and a capital stock paid in cash of $250,000 if organized after that date, with which provision Fidelity could never comply; because in Section V of its petition it sets out its reserve liability at approximately twenty-five million dollars and its assets at "approximately twenty-three million dollars." (R. 6).

The petition states, in paragraph VII, "by reason of said interest requirements under its said contracts the Debtor is now suffering an annual loss of approximately two hundred and fifty thousand dollars per annum, and that this loss will continue, and probably increase" (R. 7). Debtor further neglected to set forth in its petition that its operating expenses were 25.2% of each dollar of contract holders' money received, of which 18.9% was for selling costs alone (Ex. 6, p. 88, Report by S. E. C. to Congress), and that under the Investment Company Act of 1940 it was restricted to a loading charge of 7% total.

In view of the *Marine Harbor* decision and the language above quoted, we believe this Court will find particularly relevant the reasons Debtor stated in paragraph VII of its petition as showing the need for relief under Chapter X (R. 7).

> "• • • Debtor has been unable to meet its obligations as they mature and will be unable to meet its obligations as they mature, *unless the rights of*

its contract holders are modified so that the earnings received on securities and assets owned by Debtor will be sufficient in amount to meet the requirements under its outstanding contracts; and *if the rights of its outstanding contract holders are modified to this extent, Debtor will be able to meet its reserve requirements* and be able to comply with the Investment Company Act of 1940, and will be able to resume the operation of its business.

"* * * and that *the rights of all contract holders must be modified* as above set forth in order that Debtor may be permitted to obtain adequate relief * * *."

In substance, the Debtor, who had no equities of its own as set forth by its own petition, states openly in its petition that the rights of the secured creditors, that is the contract holders, *must be modified*, and not only must they be modified so that the Debtor can continue business and procure the increased reserves required under the Act, but modified so as to procure the capital required by the Debtor to do business under the Investment Company Act of 1940; as there is no statement or intimation that any new capital would be forthcoming.

Therefore, it is submitted that the Debtor has failed to sustain the burden of proof of showing (as required by Sec. 130[7] and Sec. 146[4] of the Bankruptcy Act) that the Chapter X proceedings will better subserve the interests of the contract holders than the prior proceedings pending in the State Courts, particularly that in the Circuit Court of Kanawha County, West Virginia.

B

Congress in enacting the Investment Company Act of 1940, intended that deposits made with State officials by face-amount certificate companies prior to January 1, 1941, should in the event of insolvency be retained by them, and the trust liens created by State statute should not be set aside; and Congress recognized the validity of, and legislated concerning, insolvency proceedings of such companies when instituted in proceedings other than under Chapter X, and permitted a very limited and strictly defined intervention therein by the S. E. C.

Intent of Congress as Expressed in Committee Hearings on Act

The Investment Company Act of 1940 was enacted as HR-10065 and was introduced in the Senate as S-4108, a substitute for S-3580. As set forth in the report of the Senate Committee on Banking and Currency accompanying S-4108 (Report No. 1775), the original bill was the outgrowth of extensive study of investment trusts and investment companies, conducted by the S. E. C. at the direction of Congress. In the original draft of the Act (S-3580) there was no provision for deposits with States or State officials, and in Section 29 relating to bankruptcy of face-amount certificate companies, it provided that every deposit made with a State agency for the benefit of the holder of any security sold on or after October 1, 1940, should be null and void as against the trustee in bankruptcy of the company. It left unaffected the status of deposits for the benefit of holders of securities sold prior to October 1, 1940.

The bill was explained to the Sub-Committee by Commissioner Healy and Mr. David Schenker, Chief Counsel for the S. E. C. Investment Trust study. He was talking about the provisions therein contained which after amend-

ment became Section 29 of the Investment Company Act, entitled "Bankruptcy of Face-Amount Certificate Companies." With respect to the deposits already made with the States as required by State laws, Mr. Schenker stated:

> "We do not disturb the present deposits and the situation with respect to future payments made on outstanding contracts."
>
> Hearings before Sub-Committee of the Committee on Banking and Currency, United States Senate, Part I, p. 302.

Under questioning by Senator Herring (Iowa) concerning these State deposits, Mr. Schenker stated that they could not unequivocally say "that such security, in the event the company were bankrupt, would be applicable to the certificate holder in the States which required security. There were certain Supreme Court cases which seemed to cast some doubt upon that fact."

> "Senator Herring. Well, we have possession of them and I would like to see them get them.
>
> "Mr. Schenker. Yes; of course you have possession of them. *We used meticulous care to see that those States which have them can hold on to them.* With respect to payments made on certificates already sold, you can keep those, too; but with respect to the future we provide differently.
>
> "Senator Herring. • • • you cannot assume that the Federal authorities are any more competent than the State authorities. If you say that, then you may want to send everything down here to Washington.
>
> "Mr. Schenker. We are not unmindful of that, and we are not disparaging present deposits.
>
> • • • • •
>
> "Mr. Healy. • • • Now, as Mr. Schenker points

out, *the existing status is not disturbed so far as the deposits are concerned.*"

(Pages 310-311, 312.)

The hearings ended after four weeks and resumed on May 31, 1940, at which time there had been a redraft of the bill. In Part IV of that hearing, pages 1124-1125, when Commissioner Healy and Mr. Schenker explained the matter to the Committee, Senator Herring stated:

> "You see our position. We are protecting our face-amount policyholders and are taking care of them, and *we are not going to give up that security*, for some State that does not take care of them."

And after some further questions, Commissioner Healy stated, with reference to provisions in the new bill:

> "What would happen if the company went into bankruptcy would be this: *The people in your State should use up the deposit;* and then if it had not been paid for in full, when they came to take their share out of the national deposit, there would be an equalization process there, so that their share of the settlement recovered would be the same as everybody else's. But in the meantime *they would have that deposit.*"

In the afternoon of that day, Mr. Schenker made the following statement, in part:

> "The way the proposed law is set up, the Investors' Syndicate may form a new company after the enactment of this bill. They may stop selling in the old company, although they will make collections on certificates, so that *this bill in no way, Senator Herring, touches deposits that have been made to secure certificates issued up to the time of the passage* of this bill. • • • If such deposit is made and the company goes bankrupt, then *certifi-*

cate holders of a State in which the deposit was made will get a preference with respect to moneys realized on liquidation of this collateral. * * * So we have not abolished deposits. * * *

"Senator Herring. It will be just a question of whether a State will be willing for a company to do business in that State. In the case of our State, we will expect protection for certificate holders.

"Mr. Schenker. * * * In other words, this bill does not prevent any State in the future insisting upon a deposit for the protection of its certificate holders.

"Senator Wagner. In other words, *it does not change the present status.* I mean, so far as the requirement of a deposit is concerned.

"Mr. Schenker. That is right. (The bill makes an addition). The addition is that where you have a deposit in a State, and the certificate holders get a sum of money on that deposit, they cannot share in the general funds of the company until other people receive an amount equal to what the people in that State receive."

This is similar to the provision in the West Virginia depository law (Code 33-9-3), which provides that where a deposit is made in a State for the contract holders therein, they can only share in the West Virginia fund to the extent that a deposit was not made in their State fully to protect them, but the difference of the deposit was placed in the West Virginia fund for the benefit of the contract holders of that State.

Mr. Schenker went on to state, immediately following the above:

"So that if a security commissioner of a State has a 100 percent deposit, and a company goes

bankrupt, *the deposit he holds will be liquidated and certificate holders in that State will receive the money and be paid in full.*

"Senator Hughes. But they get the full benefit of their deposit?

"Mr. Schenker. Yes. And the securities commissioner of a State can require a deposit in any amount he wants.

"Senator Herring. I think that is all right."

Hearing, Part 4, pp. 1128-1129.

Senator Wagner, Chairman of the Committee on Banking and Currency, made the report accompanying the substitute bill (S-4108), the report number being 1775. With respect to the provisions concerning State deposits, Senator Wagner stated, in part:

"The bill *preserves the rights of residents* in those States which require specific deposits with their State officials."

On June 12, 1940, Representative William P. Cole, Jr., Chairman of the House Sub-Committee on Interstate and Foreign Commerce, introduced HR-10065, a companion bill to S-4108, and submitted Report No. 2639, which states, in part:

"Section 29. Bankruptcy of face-amount certificate companies, subsection (a); while *preserving the rights, even in the event of bankruptcy, of residents in those States which require specific deposits* with their State officials, * * *."

Therefore, Congress, in passing the Investment Company Act of 1940, specifically intended the deposits made with the States prior to January 1, 1941, to remain in those States, under the custody and control of the State

officers properly entitled thereto, and in the event of insolvency Congress especially intended that these deposits should be liquidated and distributed in the States, for the benefit of the contract holders in those States.

In any event, the provisions of the Act were to apply only to deposits made on contracts sold after January 1, 1941. In our instant case no deposit was made in any State after that date, so the deposits previously made were intended by Congress to be retained by the depository States.

Congress Strictly Defined and Delimited Intervention by the S. E. C. in Insolvency Proceedings of Investment Companies Such as Fidelity, and Enacted Specific Provisions for Such Proceedings When Instituted Other than Under Chapter X.

The S. E. C. in its original draft of the Investment Company Act of 1940, provided for wide discretionary powers by it with reference to investment companies, their reorganization and insolvencies. As stated in 50 Yale Law Journal 442:

> "While it was never seriously proposed to outlaw investment companies entirely, the original bill for Federal regulation, submitted by the S. E. C. to Congress (March 1940) surpassed even the Holding-Company Act in grants of discretionary power to the S. E. C. Whether it would have been politically possible to pass the bill in its original form is questionable. At any rate the present bill is a drastic modification . . . ."

As finally enacted, Section 3(a) defines investment companies, and subsection (2) includes companies selling face-amount certificates on the installment plan. There were only three of them then in existence in the United States, and Fidelity and Investors Syndicate, the two principal ones, were discussed by the S. E. C. with the

Congressional Committees. So the Act was definitely intended to cover Fidelity.

Section 25 of the Investment Company Act as passed by Congress is entitled "Plans of Reorganization." This section contains provisions concerning proceedings for reorganization of all investment companies, including face-amount certificate companies, instituted in *any* court of competent jurisdiction. Congress was not dealing with reorganization under Chapter X, because that was already law, and in (d), the final subsection of Section 25, Congress enacted that the section was not to derogate from or affect the powers of the Courts of the United States and the S. E. C. with reference to reorganizations contained in the Bankruptcy Act as amended. Also, subsection (c) provides for injunctive proceedings in District Courts to restrain these other proceedings under certain circumstances.

Therefore, Congress in enacting Section 25 clearly intended and recognized that investment companies, including face-amount certificate companies, could have reorganization proceedings in State Courts. A mere reading of this section will refute petitioners' contention that Congress intended all such proceedings to be under Chapter X, and under a Court with "national jurisdiction."

And Congress not only recognized the validity and legality of such State Court proceedings, but enacted into the Act the specific and limited part the S. E. C. could play therein. And this after a full hearing upon a bill presented by the S. E. C., giving that body, as above stated, practically unlimited supervisory jurisdiction and veto powers over such reorganization proceedings.

As stated in 50 Yale Law Journal 454:

> "The original draft of Section 25 gave the S. E. C. veto powers over reorganization plans unless they met the bankruptcy standard of being 'fair, equitable and feasible' . . . ." As finally redrafted, however, Section 25 gave the S. E. C. practically no powers over reorganization proceedings of investment companies, except for the possibility of the Commission exercising an extra statutory authority.

Therefore, we submit, Congress intentionally provided for and permitted proceedings such as those pending in the State Courts when the Chapter X proceedings were instituted, and apparently contemplated, as these respondents contend, that such proceedings could be consummated with only limited aid from the S. E. C.

Section 25(b) of the Investment Company Act provides that the S. E. C. is authorized, if requested by 25% of the holders of any class of securities, or by any registered investment company, to render an advisory report on plans of reorganization, which is then required to be mailed to interested persons. However, even if so requested, if the fairness or feasibility of such plan is in issue before *any Court* of competent jurisdiction, such report cannot be rendered unless submitted by the Court to the S. E. C. for that purpose.

Section 25(c) makes provision for those cases in which S. E. C. was not invited into the State Court proceedings, and gives that body certain rights and control over those proceedings nevertheless. This section provides:

> "Any [U. S.] district court [in the state of incorporation, or where the company maintains its principal place of business] is authorized to enjoin the consummation of any plan of reorganization

> * * * upon proceedings instituted by the Commission [who shall appear for the security holders], if such court shall determine any such plan to be grossly unfair or to constitute gross misconduct or gross abuse of trust on the part of the officers, directors * * * or other sponsors of such plan."

And this *is the full extent of the provision Congress made for S. E. C. participation in reorganization of investment companies*, including Fidelity, when not under Chapter X.

But it is stated in 50 Yale Law Journal 443:

> "Although the role of the S. E. C. is ostensibly little more than that of a watch dog, with power to enforce the Act by stop order, injunction or criminal prosecution, it seems likely that the Commission will exercise considerably greater power by way of persuasion than a literal reading of the Act would imply."

The Congressional intent is further discerned from Section 29(a) of the Investment Company Act, entitled "Bankruptcy of Face-Amount Certificate Companies," the section under discussion in the above colloquies between the S. E. C. and the Congressional Committee. While in Section 25 Congress dealt with reorganization of all categories of investment companies, including face-amount certificate companies, in Section 29(a) Congress set out special provisions dealing with bankruptcy of this latter class alone; and placed this section, enacted as part of the Investment Company Act, as an amendment to be at the end of Section 67 of the Bankruptcy Act of 1898 as amended; and Section 67 is in Chapter VII, or straight bankruptcy.

Subsection (f) (2) of Section 29(a) provides that deposits with State officials for protection of contracts sold

after *January 1, 1941*, shall be voidable at the option of the Trustee, if the company is insolvent and "cannot make full payment and discharge on account of all face-amount certificates sold by Debtor." But subsection (3), immediately following, provides the *liens created by the State deposits must be recognized and given effect*:

> "In the event any deposit or transfer described in paragraph 2 of this subsection (f) shall be avoided the trustee shall segregate the property received by the trustee from the depository and charge the same with the costs and expenses of maintenance and *liquidation* and *distribute the net proceeds thereof to the creditors who would have been entitled thereto under the provisions of the law or agreement providing for the deposit* or transfer of the property; * * *."

Congress made no provision for participation by the S. E. C. in bankruptcy of face-amount certificate companies, except under Section 29(b), which provides that the District Court alone shall appoint the Trustee, but only after notifying the S. E. C. and giving it an opportunity to be heard.

We again call the Court's attention to the use by Congress of the word "liquidation" in subsection (3), quoted immediately above.

This was not an oversight upon the part of the S. E. C. or Congress, because under former Section 77-B(c)(8) of the Bankruptcy Act the Judge, in addition to the reorganization powers conferred upon him by Section 77-B, could under certain circumstances "direct the estate to be liquidated, or direct the Trustees to liquidate the estate * * *."

Section 236 of Chapter X, together with Sections 237 and 238, were substituted in place thereof when Section 77-B was amended and became Chapter X, and were

specifically considered by Congress, as shown in the report of Senate Committee on the Judiciary, May 27, 1938, page 37. The provision of Section 77-B empowering the District Court to order liquidation of the debtor was not enacted into Chapter X, but instead the District Court under Section 236 of Chapter X has the option of dismissing the petition or adjudicating the debtor a bankrupt.

In other words, Congress in its original enactment on reorganization proceedings in Section 77-B had directed that liquidation could ensue in those 77-B reorganization proceedings in the event of failure of rehabilitation; but after due consideration, when it passed the Chandler Act amending Section 77-B into Chapter X, Congress expressly withdrew liquidation of corporations from reorganization proceedings. Instead the Court, under Sections 236, 237 and 238, in the event rehabilitation fails, can either dismiss the petition, or adjudicate the Debtor a bankrupt. In the latter event, Chapters I to VII of the Bankruptcy Act apply, which include no intervention by the S. E. C.

Further to show that Congress did know and realize the distinction between "rehabilitation" and "liquidation" is shown by 11 U. S. C. A., Section 203(i), providing for confirming a farmer's proposal by the Bankruptcy Court if satisfied "(1) it includes an equitable and feasible method of *liquidation* for secured creditors and of financial *rehabilitation* for the farmer * * *."

Likewise, the S. E. C., in its Report to Congress on the study, etc., of Protective and Reorganization Committees, Part VIII* at page 2, stated:

> "The term 'reorganization' in this, as in the foregoing parts of this report, is applied to all sorts

*Submitted by Jerome N. Frank, chairman, the study being headed by Mr. Justice Douglas during his period as chairman, p. iii.

of changes which affect the rights of security holders, except *actual liquidation under State statutes* or under the Bankruptcy Act."

The petitioners and the S. E. C. contend that only under Chapter X can liquidation proceed in a slow and orderly manner, and apparently take the position that straight bankruptcy requires something otherwise.

Chapter 2 of the Bankruptcy Act, Section 2(a) (5), provides that bankruptcy courts have the power to "authorize the business of the bankrupt to be conducted for limited periods by receivers, the marshal or trustee, if necessary in the best interests of the estate * * *." Subsection (7) permits the Court to "cause the assets of the bankrupt to be collected, reduced to money and distributed * * *." Therefore, there is nothing in Chapters 1 to 7 (straight bankruptcy) which requires speed or haste in regard to liquidation where it would be against the best interests of the bankrupt or of the creditors, and no need to stretch the reorganization provisions of Chapter X as enacted by Congress, to include liquidation therein, especially since it was taken out by Congress.

Therefore, we respectfully insist that our interpretation of the intent of Congress is sound. For liquidation of ordinary corporations straight bankruptcy is available; for reorganization of corporations (meaning rehabilitation), Congress, in September 1938, enacted Chapter X, and set forth the part the S. E. C. was to play therein. For bankrupt face-amount companies Congress, in August 1940, in the Investment Company Act of 1940, Section 29, amended the straight bankruptcy provisions of the Bankruptcy Act, and set forth a procedure for their liquidation, including an optional voiding by the Trustee of State deposits made after January 1, 1941, but with full recognition of all liens, trust relationships or other rights

acquired by virtue of the State statutes requiring the deposit, and with the S. E. C. to have no part therein.

For reorganization of investment companies, including face-amount certificate companies, Congress prescribed therefor in Section 25 of the Investment Company Act, and provided in (b) that under certain circumstances, the S. E. C. could be invited into such proceedings, to a limited extent, by the security holders, the company or the Court.†

Section 25 further provides in (c) that if the S. E. C. is not invited into the reorganization proceedings of investment companies, it may still exercise a degree of control over them, by having consummation of unfair or fraudulent plans enjoined in a Federal District Court.‡

Thus Congress rounded out its entire scheme or plan for insolvent corporations, which, we submit, should not be disrupted to permit the attorneys for the S. E. C. to carry their rights and duties from one category or class into all the others; especially when there is no urgent need therefor, and in opposition to the expressed intent of Congress.

So, it is respectfully submitted that Congress did not intend an annuity company such as Fidelity, in any event, to partake of the provisions of Chapter X for liquidation purposes, and it is further submitted that Congress particularly was careful to avoid the enactment of legislation which upon insolvency would in any way disturb the deposits made with the States, or the trust liens of the contract holders thereby acquired; and Congress expressly recognized that liquidation of investment companies, such as was Fidelity, could take place in State Courts.

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†Congress apparently recognized that reorganization of investment companies were for State Courts, because had Congress intended them to be under Chapter X, no such invitation to the S. E. C. would be necessary.

‡This also indicates Congressional contemplation and recognition of investment company reorganizations in State Courts.

C

Securities were deposited in trust with States or State officials by Fidelity as required by valid State laws, for the benefit and protection of the purchasers and holders of Fidelity contracts in those States, and such securities so deposited should not now be taken from those States or State officials, and the trust lien thereby created in favor of the contract holders in each such State should not be nullified or avoided.

The typical contract sold by Fidelity had a provision in Section 1 that the reserve fund "shall be invested in approved securities and deposited in trust as required by the laws of the State of West Virginia," or "shall be invested in securities and deposited with State authorities in trust."

The applicable feature of the West Virginia law (Code 33-9-3) requires that securities approved by the Insurance Commissioner shall be deposited "with the State Treasurer * * * in trust, for the benefit of its contract holders."

It is uncontrovertible that a State may make such reasonable restrictions as it desires before permitting a charter to be issued for a domestic corporation and before permitting it to receive a license to do business in the State, and the deposit law of West Virginia, so far as it concerns Fidelity, a West Virginia corporation, is, of course, unchallenged.

With regard to the other depository States, the deposit is exactly the same as that required of a foreign insurance company as a condition prerequisite to its being permitted to engage in business within the State, and this Court early upheld the constitutionality of State statutes requiring a deposit for the protection and benefit of local citizens of a State before a foreign insurance company

would be permitted to do business in the State. *Paul* v. *Virginia*, 75 U. S. 168, 19 L. Ed. 357. In upholding the constitutionality of such a Virginia statute, this Court stated: "They may exclude the foreign corporation entirely * * * or they may exact such security for the performance of its contracts with their citizens as in their judgment would best promote the public interest. The whole matter rests in their discretion."

In re Bajardi, 8 F. (2d) 551:

> "The power of the State to require the deposit of the securities as a condition precedent to the transaction of business in this State is unquestioned."[8]

The rights of such insurance companies are governed by the statutes in force in the State when the securities are deposited therein, and the interpretation thereof by the Courts of the State. *Lawson* v. *Aetna Ins. Co.* (W. Va.), 41 F. (2d) 316.

Therefore, there can be no real challenge to the validity of the laws requiring the State deposits.

The State Deposits Constitute Trust Funds for the Benefit of the Contract Holders Which May Not Be Avoided or Nullified

There were fifteen States in the United States which required and received a deposit by Fidelity, and there are thirty-six States in the United States which required and received a deposit from either Fidelity or Investors Syndicate, the other company doing a similar annuity business to that of Fidelity. The question then arises whether, upon insolvency of the depositing company, such a deposit of securities made in compliance with valid State statutes can or should be retained and administered by the State authorities with whom the deposit was made, and whether such deposited securities in each State were

[8] See accord 29 R. C. L. 68, Sec. 32.

trust funds for the benefit of contract holders in those States, which trust liens should not be destroyed or set aside.

This Court decided (1898) the status of such funds deposited with States, in the case of *Blake* v. *McClung*, 172 U. S. 239, 43 L. Ed. 432, at 439.

The actual decision in that case was that a statute of Tennessee in giving a preference in the distribution of the assets of an insolvent foreign corporation was unconstitutional, but the Court in its decision stated:*

> "* * * the objections to the statutes of Tennessee do not necessarily embrace enactments that are found in some of the States requiring foreign insurance companies, as a condition of their coming into the State for the purposes of business, to deposit with the state treasurer funds sufficient to secure policy-holders in its midst. *Legislation of that character does not present any question of discrimination against citizens forbidden by the Constitution.* Insurance funds set apart in advance for the benefit of home policy owners of a foreign insurance corporation doing business in the State are a *trust fund of a specific kind to be administered for the exclusive benefit of certain persons*, * * * funds or property *specifically set aside as a trust fund, and at the outset put into the custody of the state, for the exclusive benefit, or for the benefit primarily, of Tennessee creditors*, * * *."

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*Because of the pertinency we quote at length.

†The digests state the general rule and the reasons therefor:
In 104 A. L. R. 748, 749:

"In order to protect the interests of residents in their dealings with foreign corporations most States have adopted statutes requiring foreign corporations, and more especially insurance, surety, or other corporations, * * * to deposit with the State, as a prerequisite to their doing business therein, securities or a

And recently this Court held that such deposit cannot be taken from possession of the State official holding it, and domestic creditors may have exclusive remedy against the fund, if such is the policy of the depository State.

In the case of *Fischer* v. *American Life Ins. Co.*, 314 U. S. 549, 86 L. Ed. 328, Mr. Fischer, Commissioner of Insurance of the State of Iowa (also a respondent in the case at bar), as such, was the custodian of a deposit made by a foreign insurance company in the State of Iowa for the benefit of policyholders in that State, which company later became insolvent. The policies were re-insured by a Michigan company, the deposit remaining unchanged, and then the re-insuring company became insolvent. Mr. Fischer instituted his proper suit in State Court for the administration and distribution of said deposit for the benefit of the Iowa policyholders, and because of the claim by the Michigan receiver that the latter "had title to all of its assets wherever situated," Mr. Fischer brought a suit in Federal Court to remove an encumbrance, lien or cloud upon the title of the property. This Court held that:

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bond, * * * and the Courts are inclined zealously to guard the rights of residents arising under such statutes.

"* * * by the interpretation of most Courts it (the deposit) is considered *as a trust held by the State for the protection of those doing business with the corporation.*

* * *

"* * * in the majority of cases the Courts have held that such protection extended only to such resident claimants."

In 29 R. C. L. 69-70, Sec. 32, it is further stated:

"*The deposits constitute a special trust fund* for the purpose of meeting the depository company's policy obligations arising out of the transaction of business within the State, and may be subject thereto."

Again at 29 R. C. L. 107-108, Sec. 81:

"Generally a deposit with a State official creates *a trust* for the benefit of policy holders in case of insolvency, to the exclusion of other claims."

And in 29 R. C. L. 108, Sec. 82:

"Requirement of funds or deposits from foreign insurance companies are generally regarded as having for their purpose the protection of the resident claimants."

> "* * * even if that claim of the Michigan Receiver were true, that nevertheless claimants entitled to the benefit of the fund in Iowa might pursue their suits and remedies against it and in derogation of the claim of the Michigan Receiver if that were Iowa's policy. *Clark* v. *Willard*, 294 U. S. 211. That is the asserted Iowa policy here. The Iowa Receiver is in possession of the securities in question; * * *."

and

> "We repeat that neither Michigan nor Texas is entitled to the securities if such a disposition of them would contravene Iowa law."

The Federal Courts in *In re Bajardi*, 8 F. (2d) 551, and in *In re Rosett*, 204 F. 431, have held that "the proceeds of the securities there deposited are impressed with the trust and must be applied and distributed as provided in" State statutes. See also *Firemen's Insurance Co.* v. *Hemmingway*, Fed. Case No. 4794.

A number of State Courts likewise have made decisions regarding deposits made with the States, and unanimously uphold the contention of these respondents, that such deposits are *trust funds for the benefit and protection of domestic creditors and policyholders*, and in the event of insolvency of the depository company, are to be retained in and by the depository State.*

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*Lewis v. *American Savings & Loan Ass'n*, 98 Wis. 203, 73 N. W. 793.
Phillips v. *Perue*, 111 Tex. 112, 229 S. W. 849.
State ex rel. Stevenson v. *Stephens*, 136 Mo. 537, 37 S. W. 506.
Texas F. Bonding Co. v. *Austin* (Tex.), 246 S. W. 1026.
Senter v. *Lockhart, Treasurer* (Tex.), 82 S. W. (2d) 375.
Crowell v. *Carroll* (Tex.), 250 S. W. 252.
In re Phillips, 200 N. Y. S. 639.
People v. *Granite State Provident Ass'n*, 161 N. Y. 402, 55 N. E. 1053.
In re Stoddard, 238 N. Y. 147, 144 N. E. 484.
In re Stoddard, 242 N. Y. 148, 151 N. E. 159.
State ex rel. Turner v. *Union Casualty Ins. Co.*, 8 Ohio App. 285, 39 Ohio C. C. 491 (Motion to certify record overruled).
State ex rel. Hutchinson (S. C.), 189 S. E. 475.
Boynton v. *Consolidated Indemnity Ins. Co.* (S. C.), 185 S. E. 734.
Pink v. *McColley* (Ga.), 18 S. E. (2d) 3.
Manufacturing Lumberman's U. v. *S. Georgia R. Co.* (Ga.), 196 S. E. 244.

Rollo, Assignee, v. *Andes Ins. Co.,* (Va.), 23 Gratt. 509:

> "The treasurer is required by the statute to retain the securities in the treasury for the special objects contemplated by the act, until the liabilities of the company are settled or terminated. So long as any thing remains to be done, so long as these liabilities continue, he is expressly prohibited from disposing of or surrendering them. * * * He *holds the securities in trust, to be administered, first for the people of Virginia, and then for the company making the deposit.* This is the distinction given them by law, controlling not only the treasurer but the courts also; and it would seem there is no power, except that of the Legislature, to change such destination [distinction?].
>
> "* * * The theory of this whole legislation is, that a foreign insurance company may come into the State, deposit its funds and securities with the treasurer, and carry on business here for an indefinite period. However long this may continue, *the securities deposited cannot be surrendered or subjected to the claims of creditors.* If this exemption be wrong, * * * the policy of this legislation is bad, and ought to be abandoned."

And this Court in *Straton* v. *New,* 283 U. S. 318, 75 L. Ed. 1060, held that in the distribution of the estate of a bankrupt that liens acquired, if valid under State law, are preserved and must be accorded priority, in accordance with applicable local law.

Even the S. E. C. in substance admitted in its brief in the Circuit Court of Appeals, below, that these trust liens created by State statute cannot be avoided, when it stated (Brief, p. 52), "The rights of contract holders by State statutes *will be recognized* appropriately by the Federal Courts in the proceedings."

Therefore, it is respectfully submitted that the securities deposited in each State should remain in that State, and with the official designated by statute of the State to receive and hold and administer that deposit, and that the States cannot and should not be compelled to turn over the deposited securities to the Central Trust Company, Trustee; and that the trust created, and the beneficial ownership and the trust liens of the contract holders in each such State should not be nullified or set aside.

The Federal Court Under Its Equity Powers Should Release Its Jurisdiction, If Any, in Favor of the State Courts

In the case of *Securities & Exchange Commission* v. *U. S. Realty and Improvement Co.*, 310 U. S. 434, 84 L. Ed. 1293, this Court held that the question therein was based "on considerations growing out of the public policy of the [Chandler] Act * * * and of *the authority of the Court clothed with equity powers and sitting in bankruptcy* to give effect to that policy * * *," and that "*a bankruptcy court is a court of equity*, and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act. * * * A court of equity in its discretion * * * may in the public interest, even withhold relief altogether; and it would seem that it is bound to stay its hand in the public interest when it reasonably appears that private right will not suffer. *Pennsylvania* v. *Williams*, * * *. This interest of the [S. E. C.] does not differ from that of a liquidator under a state statutory proceeding who may, in a proper case, intervene in an equity receivership in a federal court to ask the court to relinquish its jurisdiction in favor of the state proceeding. *Pennsylvania* v. *Williams*, * * *. Their [State Banking Commission] only interest, like that of the Commission, is a public one, to maintain the state authority and to secure a liquidation in conformity to state policy."

We submit that this Court should again follow the rule and reasoning of *Pennsylvania* v. *Williams*, 294 U. S. 176, 79 L. Ed. 841, because of the similarity of that case to the case at bar. While the case at bar is under Chapter X, and the former case involved a Federal equity proceeding, which had been instituted prior to the State Court proceedings, however, *since a bankruptcy court is in reality a court of equity*, the same principles should be applicable.

In *Pennsylvania* v. *Williams*, there was a contest between a Federal equity proceeding alleging insolvency and asking for appointment of receivers, and the Secretary of Banking of Pennsylvania, desiring to liquidate an insolvent banking company under Pennsylvania statutes particularly enacted to provide for that kind of a company. It was held that the District Court had jurisdiction and could have made the liquidation, but that under the circumstances the equity discretion of the District Court invoked by the petition of the Banking Commissioner was such that the Court should have relinquished its jurisdiction "in favor of the statutory administration of the corporation assets by the State officer," this Court stating:

> "It has long been accepted practice for Federal Courts to relinquish their jurisdiction in favor of the State Courts where its exercise would involve control of, or interference with, the internal affairs of a domestic corporation of the State. (Cases cited.) *There are stronger reasons for adopting a like practice where the exercise of jurisdiction involves an unnecessary interference by injunction with the lawful actions of State officials.*"

The italicized words are particularly and peculiarly pertinent to the case at bar.

In the case of *Gordon* v. *Ominskey*, 294 U. S. 186, 79 L. Ed. 848, a somewhat similar question was involved, with this Court again holding the District Court had acquired jurisdiction of the cause, but that upon the request of the Secretary of Banking of Pennsylvania, showing possession and control of the assets by him, pursuant to statute, the District Court, under *Pennsylvania* v. *Williams*, should have been induced by the same considerations to relinquish its jurisdiction to the State Courts.

In *Pennsylvania General Casualty Co.* v. *Pennsylvania*, 294 U. S. 189, 79 L. Ed. 850, there was a Federal Court suit to liquidate an insurance company and a similar State Court proceeding under the statutes of Pennsylvania by the Insurance Commissioner, with injunctions against interference being issued by each Court, and again the Federal Court had acquired its jurisdiction in the case because the bill there was first presented.

This Court held that the District Court's authority to entertain the suit was not restricted by the procedure of the local statute for liquidation of insurance companies, and that it had rightfully acquired jurisdiction, but that the end result "in the State Court is the liquidation of a domestic insurance company by a State officer, and in the absence of a showing that the interest of creditors and share holders would not be adequately protected by this procedure, the case was a proper one for the District Court in the exercise of judicial discretion to relinquish its jurisdiction in favor of the administration by the State officer."

This policy, so clearly expressed by this Court, of allowing the continuation of State statutory proceedings by State officials for liquidation of domestic companies, even though the Federal Court had jurisdiction of the

cause and had first acquired its jurisdiction, we believe should be a guiding principle in the case at bar.

Here the officials of six States are respondents and there are eight additional States wherein Fidelity made a deposit, joined with them *amici curiae* requesting this Court that they be permitted to continue their prior pending State proceedings to liquidate Fidelity. There are also a number of other States appearing *amici curiae* herein, all of which together total approximately one-half the States of the United States, which are respectfully urging this Court, through their Attorney Generals and other proper State officials, that depository statutes such as those in question in the case at bar be held valid, that the trusts thereby created be not nullified or avoided, and that in the event of insolvency the State officials with whom the deposits are made and who, by the statutes and laws of the States, are required to act in regard thereto, be permitted so to do, even though Chapter X proceedings are instituted.

Nearly every State has laws requiring deposits by foreign corporations, particularly insurance companies, wherein deposits must be made as a condition prerequisite to doing business in the State. It is not beyond the realm of possibility that in the future Congress may enact legislation extending the Bankruptcy Act to include insurance and other companies now exempt. If the decision of the District Court in the case at bar be upheld by this Court, and *Blake* v. *McClung*, supra, and the decision of the Court below overruled, it would mean that in the event of insolvency, the first District Court acquiring jurisdiction could require all deposits made in compliance with State law, by insurance and other such companies, to be turned over to a Trustee appointed by that Federal Court; it would permit the trust liens existing by virtue of the State depository laws in favor of domestic creditors

and policyholders to be nullified. It could literally cause millions of people to be compelled to go to a distant and foreign Federal jurisdiction to protect their rights. It is to urge this Court to decide against any such invasion of rights of the sovereign States that many of the States have enjoined in the *amici curiae* brief.

That the District Court fully intends, and believes it has the power and authority, to compel a turn-over of the State deposits to the Federal Trustee, is clear from the record. These respondents are not jousting with a shadow. Even the S. E. C. brief now advocates not only taking the deposited securities from the States, but nullifying the trust liens created by the State statutes (Brief, p. 37).

The District Court entered the turn-over order of June 6, 1941 (R. 2), and strengthened it on June 10, 1941 (R. 13); although the West Virginia respondents moved for a stay in its enforcement until the legal questions were determined, this was refused. (R. 15, 19.) The turn-over orders were amended to freezing orders on August 9, 1941 (R. 108), except the turn-over against the West Virginia State Court Receivers was not amended (R. 107). The Court expressly reserved the right to extend or modify this freezing order at any time (R. 109).

During the hearing the District Court informed Assistant Attorney General W. F. Gray of Illinois, in the record, that if jurisdiction was sustained, the Federal Trustee was to have the management of the Illinois deposit, and *if the company was liquidated, the Court had the right to require liquidation through its trustee* (R. 958).

Lastly, at the end of its written opinion in this case (R. 202), the District Court held that the State officials and Receivers were not adverse claimants. "No plenary suit is required in dealing with them. The assertion of

adverse claims, being merely assertion and no more, may be disposed of summarily, *as I have done.*"

That meant, and means, that the District Court believes it has already decided it can take the State deposits of securities from the custodians thereof, and put them under the control of its Trustee. And that is the very thing which the respondents, together with all the States appearing *amici curiae*, are so strongly contending against, and so earnestly urge this Court to prohibit.

In straight bankruptcy, the State officials, as trustees or lienholders, could liquidate the deposited securities in their possession, turning over to the trustee only the balances, if any, remaining. Hence the bitter fight by petitioners to retain the proceedings in Chapter X, and the attempt to stretch its provisions to include liquidation; all for the sole purpose of taking these deposited securities from the possession of the States and their officials, and turning them over en masse to the Federal Trustee appointed under Chapter X, and nullifying or destroying the trust liens created by State statute, as the brief of the S. E. C. advocates.

We respectfully but earnestly submit that under the equity powers of the Bankruptcy Court, this Court should follow *Pennsylvania* v. *Williams* and the other similar decisions and grant the request of these States, as prayed for by the West Virginia respondents in paragraph XV of their answer filed in the District Court (R. 78), and permit the deposited securities to be retained by the State officials, and the trust liens to be left undisturbed.

D

The Eleventh Amendment to the Constitution of the United States provides immunity to the Sovereign States holding deposits, and to the State officials in whose custody, possession and control are the State deposits, from suit or order by the District Court to such State officials concerning such deposits, and effectively prohibits a compulsory turn-over of said deposits to the Trustee under Chapter X.

The West Virginia respondents contend the deposit in West Virginia was made with the Sovereign State of West Virginia, and that the District Court was prohibited by the Eleventh Amendment to the Constitution of the United States from entering the turn-over orders of June 6th and 10th, 1941, and the "freezing" injunctive order of August 9th, 1941, against the States, or their officials; and therefore cannot take custody and possession of the deposited securities from the State officials. Since, then, the District Court is thus prohibited from exercising control over these deposited securities, and since they are substantially the only assets of the Debtor, Fidelity, it follows that reorganization of Fidelity cannot be had in Chapter X proceedings.

Following the lead of Virginia, the Mother State of West Virginia, which in 1866 enacted a requirement for a deposit to be made with the Insurance Commissioner by any foreign insurance company which came into the State to do business, such deposit to be for the benefit of the policyholders in that State, West Virginia first enacted such a law in 1867, which has been continued to the present time (Code 33-2-7).

In 1911 West Virginia first enacted legislation permitting a company, other than a life insurance company, to be licensed in West Virginia for the purpose of selling

annuities. The legislation at that time required a minimum deposit with the Insurance Commissioner of $10,000.00, and an additional deposit of securities to an amount of 100% of all its liabilities "on contracts outstanding in this State * * * in trust, for the benefit of its contract holders."

In 1921 the legislation was changed to require a $100,000.00 deposit in addition to a deposit "equal to 100% of the liability on outstanding contracts." In 1929 the law was again changed so where the deposit had formerly been required to be with the Insurance Commissioner, thereafter only the additional deposit for other States was to be made with him. Thereafter, in 1930, when the Code of West Virginia was revised, this was again amended so that the statutory law of West Virginia (Code 33-9-3) reads:

> "The Insurance Commissioner shall require the applicant to deposit with the State Treasurer (in accordance with Article 5, Chapter 12 of this Code), in trust, for the benefit of its contract holders, * * * securities * * * as may be approved by such Insurance Commissioner * * * to the aggregate amount of $100,000.00, and in addition to such deposit, such * * * corporation shall maintain at all times a deposit with the State Treasurer of bonds and securities, approved by the Insurance Commissioner, to an amount equal to the total amount which such * * * corporation may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of the deposit; * * *".

The provisions concerning deposits made with other States then follow. (Set out in the Statement [supra].)

For the purpose of the instant argument, we will restate the pertinent part of the above statute and put in place of the parentheses the exact words of the relevant

part of Section 2 of Article 5, Chapter 12, so that the deposit law reads:

> "* * * the applicant to deposit with the State Treasurer (who shall be the custodian of all securities belonging to the State of West Virginia or by law required to be deposited with the State or held in legal custody by the State), in trust, for the benefit of its contract holders, * * *."

It is the contention of the West Virginia respondents that by this language the Legislature of West Virginia intended the deposit of securities to be made with the *Sovereign State* of West Virginia, and designated the Treasurer of West Virginia as the official custodian of such deposit, with the Insurance Commissioner of West Virginia having supervision and authority thereover.

This contention is substantiated by the fact that in 1941 the Legislature amended Code 12-5-2 by adding a paragraph thereto, by which the Board of Public Works of West Virginia could fix "fair and reasonable charges for the care, custody, exchange and substitution of securities deposited by insurance companies and companies issuing annuity contracts" and deposit such charge "in the State fund general revenue." Thus the State could charge the depositor of these trust funds for expenses, as would the trustee of any conventional trust charge the settler thereof, and these charges became a part of the State's *general revenue*.

Also, in 1939, the Legislature amended Chapter 12, Article 5, by adding a new section, number 6. (Code 12-5-6.) It provided that where an approved deposit be required by statute, it may "be deemed to include and mean notes executed * * * and made payable to the *State of West Virginia*, upon demand, in the event of insolvency or default by such person or corporation, for the benefit

of those for whom such securities are deposited * * *" if the deposit were not being made with the *Sovereign State* itself, then why the legislative requirement that the notes be made payable to the *State of West Virginia*?

If this contention is sound, then the Eleventh Amendment is an absolute bar to any order or suit in any Court against this fund held by the Sovereign State of West Virginia, except such suits or actions as the Legislature has seen fit to authorize to be instituted for or by the State of West Virginia or its proper officials with relation to said deposit. The Constitution of West Virginia itself, Article VI, Section 35 (Appendix, Part II), prohibits the State of West Virginia being made a defendant in any court of law or equity; and the State of West Virginia has permitted no such suits or actions, except the suit of the Auditor in the Circuit Court of Kanawha County (Code 33-2-45).

The first decision directly sustaining this contention of respondents was made in Virginia shortly after the separation of West Virginia therefrom, and such a decision, while not absolutely binding authority in the State of West Virginia, is persuasive authority of the very highest kind.

In *Rollo, Assignee*, v. *Andes Ins. Co.*, 23 Gratt. (Va.) 509 (1873), a deposit had been made with the State Treasurer of Virginia by a non-domestic insurance company, as required by statute. A judgment creditor from still a different State brought an attachment and garnishment suit against the State Treasurer for payment of his judgment against the insurance company, procured in that foreign jurisdiction.

In holding that such attachment would not lie against the deposited fund and the garnishment action could not

be maintained against the State Treasurer, the Court said specifically:[16]

> "Something more is involved than the rights and obligations of the treasurer. *It is a question that concerns the State.* It is certainly not compatible with her sovereignty, and dignity to be arraigned before her own tribunals, at the suit of individuals, in any other mode than is prescribed by her statutes. Nor is it consistent with her interests, nor the proper administration of public affairs, that her officers shall be arrested in their public duties, and required to answer before the courts for funds or securities committed to their custody for a specific purpose, under authority of a public law. The treasurer of the State is one of the most important officers of the commonwealth, with grave, arduous and difficult duties to perform. It is impossible to foresee the mischiefs and embarrassments that will ensue, if, in addition to these duties, he is to be involved in the conflicts of creditors, to answer innumerable rival attachments, employ counsel, answer interrogatories, and otherwise consume time and attention which should be devoted exclusively to the public interests."

The facts in *State ex rel. Stephenson* v. *Stephens*, 136 Mo. 537, 37 S. W. 806, are nearly identical with those of the instant case. Under Missouri laws passed in 1889 (Sec. 8662) a deposit was required of a Montana "installment investment bond company," coming into the State to do business. In 1893 legislation was enacted for winding up such companies in event of failure, and for liquidation and distribution of their assets. In interpreting this latter statute after insolvency of the depository company, the Court held that the deposit had been

[16]Again we quote at length only because of the special pertinency.

made with the *State* of Missouri, even though it did not thereby become a part of the general funds of that State.

In *Blake* v. *McClung*, 172 U. S. 239, 43 L. Ed. 432, this Court, in speaking of a deposit of securities by a foreign insurance company made with a State Treasurer as a condition prerequisite to doing business in the State, said:

> "* * * funds or property specifically set aside as a trust fund, and at the outset put into the *custody of the State*, for the exclusive benefit, or the benefit primarily, of Tennessee creditors, * * *."

In 104 A. L. R. 748, the annotator, speaking of deposits by foreign insurance companies as a condition of doing business within a State, states:

> "Most courts hold such a deposit is considered as a trust held *by the State* for the protection of those doing business with the corporation."

The specific contention herein raised by the West Virginia respondents that because of the Eleventh Amendment, State officials having custody of a deposit made with a *State* under valid State statutes have immunity from suit or order of any Court was sustained by this Court in *Lankford* v. *Platte Iron Works Co.*, 235 U. S. 461, 59 L. Ed. 316, and *Farish* v. *State Banking Board*, 235 U. S. 498, 59 L. Ed. 330, which have never been overruled nor modified. In those cases there was a fund created by the statutes of Oklahoma for the purpose of repayment of deposits in insolvent Oklahoma banks, which fund was placed under the supervision of the Banking Board of Oklahoma. The Iron Works filed a bill in equity to compel payment of its certificates of deposit in an insolvent bank out of this fund for guaranty of deposits. This Court held that the property was that of the banks who contributed to the fund "and is accumulated in a

fund for the security of their respective depositories," and then held:

> "The *State* can be said to be a necessary party in the pending case because of its interest that the fund which it has caused to be created in pursuance of its policy shall be administered by the officers it has appointed rather than by judicial tribunals."

This Court then said that since such a construction could be given, it was necessary to consider the decision of State tribunals thereon. After discussing such decisions, this Court dismissed the action on the ground that the State Banking Board was immune from suit under the Eleventh Amendment, even though the contention was made that the fund was not under the executive or legislative control of the State and could be used solely for the purpose of paying depositors of failed banks; in other words, that the fund was held in trust for private persons, and that the State had no pecuniary interest therein. This Court held that at least the fund was under the management of the *State* through its officers; that the Federal Court had no jurisdiction to subject the management of its fund to judicial control.

The Sovereign State of West Virginia and any other State as such can be a legal trustee and hold title to the deposited property, even though there is no remedy against the State to enforce the trust. Restatement of the Law on Trusts 264, Section 95.

> "The United States or a State has the capacity to take and hold property in trust, but in the absence of a statute otherwise providing, the trust is not enforceable against the United States or a State."

Even should it be held that the deposit was only made

or required to be made with an official of the State, yet the Eleventh Amendment gives him an immunity from any order or injunction which restrains him from performing his duties, such as those required by the valid West Virginia statutes.

As stated in *Ex parte Ayres*, 123 U. S. 443, 31 L. Ed. 216:

> "* * * The very object and purpose of the Eleventh Amendment were to prevent the indignity of subjecting a State to the coercive process of judicial tribunals at the instance of private parties. It was thought to be neither becoming nor convenient that the several States of the Union, invested with that large residuum of sovereignty which had not been delegated to the United States, should be summoned as defendants to answer the complaints of private persons, * * * or that the course of their public policy and the administration of their public affairs should be subject to and controlled by the mandates of judicial tribunals without their consent, * * * *. In this spirit *it must be held to cover, not only suits brought against a State by name, but those also against its officers, agents, and representatives,* * * *."

The Eleventh Amendment will bar action against the State officer named as a defendant where he has no personal interest but is acting solely for and on behalf of the State.*

Mitchell v. *Lay*, 48 F. (2d) 79 (C. C. A. 9), certiorari denied 283 U. S. 864, dealt with an insolvent Texas insur-

Louisiana v. *Jumel*, 107 U. S. 711; *Cunningham* v. *Macon & Brunswick R. R. Co.*, 109 U. S. 446; *Hagood* v. *Southern*, 117 U. S. 52; *Murray* v. *Wilson Distilling Co.*, 213 U. S. 151; *Worcester County Co.* v. *Riley*, 302 U. S. 292; and *Read* v. *National Equity Life Ins. Co.*, 114 F. (2d) 977.

See also, *Beers* v. *Arkansas*, 61 U. S. 527, 15 L. Ed. 991, and *Missouri* v. *Fiske*, 290 U. S. 18, 78 L. Ed. 145.

ance company which had made a deposit required by statute in California. After institution of insolvency proceedings in Texas, the Insurance Commissioner of California instituted proceedings in his State Court as provided by statute. A Federal Court proceeding was instituted, ancillary to the Texas proceedings, and therein the District Court enjoined the Insurance Commissioner of California from proceeding further in the State receivership proceedings and from interfering with the Federal Court Trustee's possession of the Debtor's deposited assets. In effect, a turn-over and injunction order, the same as in the case at bar.

That Insurance Commissioner likewise appealed from the ruling, and in reversing the decision of the District Court and holding the injunction and turn-over order invalid, the Circuit Court of Appeals held:

> "• • • This injunction prohibits the Insurance Commissioner from performing the duties imposed upon him by State statute (liquidation of insolvent companies). The order directs the Insurance Commissioner to violate his official duties under such statute by turning over to the receiver of the Federal Court *a fund that was in the custody of the State* through its officers for the protection of the creditors of insolvent insurance companies before this action was begun."

And the Court stated this injunction order was entered because the Insurance Commissioner was doing his duty, not because he was neglecting it.

> "The mere statement of this situation is sufficient to show the impropriety of the order of the District Court. • • • The Federal Court had no right to enjoin the further prosecution of that action."

The highest Courts of West Virginia and Virginia, have by their decided cases upheld the exclusive jurisdic-

tion of the administrative bodies of the State and its agents and appointees, holding that the administrative bodies are such a part of the Sovereign State as to be immune from suit under the Constitution; and permitting exclusive control by those administrative agencies of matter placed by statute under their control.[11]

In *Picklesimer* v. *Morris*, 101 W. Va. 127, 132 S. E. 372, the West Virginia Commissioner of Banking had appointed a receiver for an insolvent bank, and the Supreme Court of Appeals of West Virginia held that thereafter a West Virginia Circuit Court had no power or jurisdiction to entertain a general creditors' suit and appoint equity receivers therein for that insolvent bank.

Therefore, the West Virginia respondents respectfully submit that there is and was no jurisdiction of the District Court to entertain any proceedings, or to enter any order, or issue any injunction against the Auditor or Treasurer of the State of West Virginia (and the officials of other depository States), concerning the funds deposited with the State of West Virginia (and other depository States), in the custory of the Treasurer, and under the authority and control of the Auditor, which were deposited in compliance with valid and applicable State statutes.

Particularly must this be true since legal title to the securities which had been deposited was vested in the State authorities in the States of Alabama, Iowa, Maryland, Wisconsin and West Virginia (Code 33-9-3 and 10), either by the requirements of their depository law, or the order or decree of a State Court, prior to the institu-

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[11] *Sayers* v. *Bullar*, 22 S. E. (2d) 9 (Oct. 12, 1942).
Carwile v. *Commonwealth* (Va.), certiorari denied Jan. 11, 1943, 11 L. W. 3209.
Mahone v. *State Road Commission*, 99 W. Va. 397, 129 S. E. 320.
Gordon v. *State Board of Control*, 85 W. Va. 739, 102 S. E. 688.
Miller v. *State Board of Agriculture*, 46 W. Va. 192, 32 S. E. 1007.
State ex rel. P. S. C. v. *B. & O. R. R. Co.*, 76 W. Va. 399, 85 S. E. 714.

tion of the Chapter X proceedings. (See Appendix, Part III.)

As Mr. Justice Miller stated in his famous dissent in *B. & O. R. R. Co. v. Baugh*, 149 U. S. 368, 37 L. Ed. 772, cited by this Court with approval in *Erie R. Co. v. Tompkins*, 304 U. S. 64,

> "• • • The Constitution of the United States recognizes and preserves the autonomy and independence (of the States) in their legislation and independence in their judicial departments • • • (and) any interference with either • • • is an invasion of the authority of the States, and to that extent a denial of its independence."

II

THE STATE COURTS IN THE STATES IN WHICH THE DEPOSITS ARE LOCATED ARE BEST FITTED TO INTERPRET AND DECIDE THE STATE DEPOSITORY LAW UNDER WHICH THE DEPOSITS MUST BE DISTRIBUTED TO THE CONTRACT HOLDERS IN EACH SUCH STATE.

State Courts Should Interpret State Depository Statutes

As held in *Guaranty Trust Co. v. Blodgett*, 287 U. S. 509, 513, the existing statutes of a State when applicable must be considered by Federal Courts in the same manner as if the words of the State law had been adopted, and specifically reenacted by Act of Congress; and as held in *Knights of Pythias v. Miles*, 255 U. S. 559, 65 L. Ed. 785, the Supreme Court of the United States must accept the construction given to a State statute by the highest Court of the State as though it were specifically expressed in the statute. We believe it is axiomatic that in deter-

mining questions as to title of property the Federal Courts are bound to apply the laws and rules of property of the State in which the property is situate, and to decide the controversy as the State Court would, and that in the administration of the local law of a State that the Courts of the United States follow implicitly the settled decisions of the Courts of last resort of the State in question. See notes in 6 L. Ed. 290; 18 L. Ed. 350.

Glenn v. *Field Packing Company*, 290 U. S. 177.
Hartford Accident & Indemnity Co. v. *Nelson Mfg. Co.*, 291 U. S. 352, at 358.
Lee v. *Bickell*, 292 U. S. 415, at 425, 426.

The Trustee, one of petitioners herein, in its brief filed in the Circuit Court of Appeals, stated (p. 8):

> "Since the (depository) statutes vary widely in their language, it is probable that no uniform construction can be applied to them, and that each must be construed according to its own terms."

With that we agree.

Therefore, in the case at bar, it is apparently agreed that the right of the contract holders in each State will be determined by the depository law thereof, since the Trustee in that brief also stated (p. 9):

> "Whatever effect any State statute requiring the deposit of assets therein may have upon the rights of the creditors in that State can be as well determined by the Federal Court as by the State Courts.";

and the S. E. C. in its brief in the Circuit Court of Appeals stated (p. 52):

> "The rights of contract holders by State statutes will be recognized appropriately by the Federal

> Courts in the proceedings. We do contend the assets should be administered in the Bankruptcy Court and the rights under the State depository statutes there determined and recognized."

Therefore, the question for determination is *whether petitioners have proven that the Bankruptcy Court is more capable of interpreting and deciding the meaning of the State depository laws than the Courts of the States where legislatures enacted them*, and whose contract holders' rights are affected thereby.

This Court has repeatedly stated that questions of State law are for the decision of State Courts. In *Clark* v. *Willard*, 293 U. S., at 130, it is stated in the minority opinion:

> "But this Court is neither called upon, nor can it without impropriety, discuss mere questions of state law. * * * It is not our function to suggest to State Courts how they shall interpret their own laws; theirs is the duty of deciding such matters; ours requires forbearance from tendering advice in that regard."

More recently this Court, in *R. R. Commission of Texas* v. *Pullman Co.*, 312 U. S. 496, at 501, 85 L. Ed. 971 (a case involving the validity of a ruling by the Commission that all persons acting as Pullman conductors must hold that rank, which ruling had been enjoined below), in remanding the case to the District Court to be retained therein pending institution of an action in State Court for determination therein of the questions of State law and policy, held:

> "But no matter how seasoned the judgment of the District Court may be, it cannot escape being a forecast rather than a determination. The last word [on interpretation of State law] belongs neither to us nor to the District Court but to the

> Supreme Court of Texas. * * * Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies, whether the policy relates to * * * the administration of a specialized scheme for liquidating embarrassed business enterprises, Pennsylvania v. Williams, 294 U. S. 176, 79 L. ed. 841, 55 S. Ct. 380, 96 A. L. R. 1166; or the final authority of a state court to interpret doubtful regulatory laws of the state, Gilchrist v. Interborough Rapid Transit Co., 279 U. S. 159, 73 L. ed. 652, * * * These cases reflect a doctrine of abstention appropriate to our federal system whereby the federal courts, 'exercising a wise discretion,' restrain their authority because of "scrupulous regard for the rightful independence of the state governments' and for the smooth working of the federal judiciary."

Those above quoted words of Justice Frankfurter were prophetic for the case at-bar. This company and Investors Syndicate were carefully supervised and controlled by the States, just as are insurance companies. The attempted intervention of the Federal Courts and the S. E. C. with the disposition of this insolvent company has created a needless friction and an unnecessary interference with State policies. The fact that these respondents are here and are joined as *amici curiae* by other States holding a Fidelity deposit, and by still other States with similar depository laws, but having no Fidelity deposit, in their efforts to prevent encroachment of Federal powers upon what they deem and believe to be within the province of the States and State officials and State Courts, speaks for itself as to the creation of friction and interference with State Court authority to interpret State laws. The needlessness thereof we leave for the determination of this Court.

Other decisions of this Court upon the same subject matter are:

Kline v. *Burke Construction Co.*, 260 U. S. 226, at 235:

> "The rank and authority of the (Federal and State) courts are equal but both courts cannot possess or control the same thing at the same time, and any attempt to do so would result in unseeming conflict. The rule, therefore, that the court first acquiring jurisdiction shall proceed without interference from a court of the other jurisdiction is a rule of right and law based upon necessity. • • •"

Toucey v. *New York Life Insurance Co.*, (Nov. 17, 1941), 10 Law Week 4025, 86 L. Ed. 107:

> "The act of 1793 expresses the desire of Congress to avoid friction between the Federal Government and the States resulting from the intrusion of Federal authority into the orderly functioning of a State's judicial process.
>
> "We must be scrupulous in our regard for the limits within which Congress has confined the authority of the courts of its own creation. Taylor v. Carroll, 20 How. 582, 597. The legislation of Congress, in organizing the judicial powers of the United States, exhibits much circumspection in avoiding occasions for placing the tribunals of the states and of the Union in any collision."

This Court unanimously followed the holding and decision of the *Pullman* case in the case of *Chicago* v. *Fieldcrest Dairies, Inc.*, April 27, 1942, 10 Law Week 4039, 86 L. Ed. 888, and remanded the case to the District Court to be retained pending decision by the State Court in a suit to be brought therein. This decision involved an interpretation of milk ordinance of the City of Chicago and the

question of its unconstitutionality and invalidity, and it was there held:

> "We are of the opinion that the procedure which we followed in the Pullman case should be followed here. Illinois has the final say as to the meaning of the ordinance in question."

It was again held that even this Court would be merely making a forecast as to what would be the ultimate decision of the Supreme Court of Illinois, and the Federal Court was being asked to decide an issue that might be displaced the next day by State adjudication, and the Court stated:

> "The delicacy in that issue and an appropriate regard 'for the rightful independence for state governments' (Beal v. Missouri Pacific R. Co., 312 U. S. 45-50) re-emphasizes that it is a wise and permissible policy for the Federal Chancellor to stay his hand in absence of an authoritative and controlling determination by the state tribunals. * * * In this case that discretion calls for a remission of the parties to the State courts which alone can give a definite answer to the major questions posed. Plainly they constitute the more appropriate forum for the trial of those issues. Considerations of delay, inconvenience and cost to the parties which have been urged upon us do not call for a different result, for we are here concerned with a much larger issue as to the appropriate relationship between Federal and State authorities functioning as a harmonious whole."

In the case at bar, we believe the words of Judge Soper, of the Fourth Circuit Court of Appeals, in deciding the instant question below, are pertinent (R. 262):

> "Moreover, it must be borne in mind that the rights of the contract holders in the several States

> must be determined in each instance by the local statutes, and that these statutes must be interpreted in accordance with the decisions of the State Courts. It is no reflection upon the Federal Court to suggest that the State Courts of the fifteen States are better qualified to construe and apply their own laws."

Petitioners contend that the District Court should interpret and decide the depository laws of each of the fifteen States and is better qualified to do so than the highest Courts of each of those States. Regardless of personal qualifications, such a decision would be, as this Court states, merely a forecast and not a finality, and could be set aside by each of those State Courts "the next day."

Necessity of an Interpretation of State Depository Statutes

While in a few States there has been a partial interpretation of the depository laws of those States, yet in a majority of the States there has not been a decision and interpretation by the Court of last resort of their depository laws, and particularly is this true of the depository laws in connection with annuity companies such as Fidelity, most of which were enacted within the last two decades. Furthermore an interpretation as to who are the specific beneficiaries of the trust created by the State deposit, and those who are to be included in the class of beneficiaries, and those who are to be excluded, has not been made in any of the State Courts; yet this will have to be decided by a legal interpretation of the depository law of each State by some competent Court.

It must be kept continually in mind that with a few exceptions, there are insufficient funds on deposit in each State to pay off in full the rightful claims of the contract holders in that State. Therefore, the question is pre-

sented as to how each State shall distribute the funds deposited therein among those entitled thereto. If one group receives more, *a fortiori* others will receive less. And respondents contend that the distribution and decision as to the exact beneficiaries, and the exact proportion of his claim that each contract holder as such beneficiary will receive, are purely problems for the Courts of each State; that is, an interpretation and decision as to their own depository law should be made by the Courts of the State enacting that law, as admittedly, the laws of each of the fifteen depository States are dissimilar.

In each State it will be necessary for a court to determine whether anyone who ever paid money into Fidelity on a contract will be included in the class of beneficiaries meant to be included within the terms of the depository statute; or whether those who were currently paying in on April 4, 1941 (when its accounts were frozen by Auditor Sims), are to be included, even though they had not then acquired a reserve or cash surrender value under the terms of their contract; or whether only those who by their contracts had acquired a reserve or a cash surrender value thereon shall be exclusively entitled to participation.

Again, as between those found entitled to share in the deposit of each State, the local Court must decide whether they are to share on the basis of cash surrender, or reserve value, or amount paid in, as under each basis different amounts will be allocated depending on the length of time the contract was in effect.

Also, in Illinois, Kansas, Indiana, and to a lesser degree, Ohio, deposits were made in those States in compliance with certain existing statutes, and at other times contracts were sold when no depository requirements were in effect. Surely, the question as to which of the contract holders in each of these States shall participate

in the funds deposited therein is a problem solely for the Courts of each of those States to determine.

Of necessity, since there are fifteen different depository States in the case at bar, each with its own depository statute or requirement, there will have to be a decision on the State law of each of those States, expressly based upon its own laws and upon its own decided cases. *And this is admitted in the S. E. C. brief, p. 45.* The basis of participation in each State's deposited fund is purely *a local problem of law within each State*, as apparently by the deposit law of each State, except West Virginia, only domestic contract holders are entitled to share in the distribution of the deposited funds.

The peculiar provisions of the West Virginia depository statute (Code 33-9-3) are set out elsewhere herein. It is apparently provided that when "by the laws of any other State" a deposit is required equal to or greater than that required in West Virginia (100% of cash liability), then there shall be no deposit required in West Virginia for the contract holders of such a State. This apparently applies to Alabama, Delaware, Iowa, Kentucky, Maryland, Missouri, Tennessee, Wisconsin, and probably to Illinois. In any event, the percent of deposit to the liabilities (percentage of solvency) in each of those States is such that there is every probability their contract holders will receive more from their deposited securities than will those who participate in the West Virginia deposited fund (See Appendix, Part IX). In this event, they would then apparently have no claim over against the West Virginia fund; but this is a question that can be finally settled only by the State Court in West Virginia.

It may well be contended that the West Virginia depository law (Code 33-9-3) apparently means that those above named States actually have no right ever to participate in the West Virginia deposited fund because they had a

100% deposit law of their own (Code 33-9-3), and no deposit was made in West Virginia for their contract holders; and the West Virginia statute provides they "shall not be entitled to the benefit" of the West Virginia fund "except so much of such deposit as may be made to complete the total amount required by this article where the law of any other State requires a lesser amount." By that it is not meant to say that if they are not paid in full, they are not entitled to participate in any undeposited funds in West Virginia, because they probably are. But their right to participate in the West Virginia deposited securities is surely a question that must be decided by a West Virginia State Court.

If, therefore, these 100% deposit law States will in no event participate in the deposited funds in West Virginia, then in each of the above named depository States, *there must be an entirely autonomous* proceeding in the Courts thereof. Only their own contract holders, as determined by their own Courts, can share in their deposited securities, and only on the basis that the local Court therein determines; and they can have no claim against the funds in West Virginia, and the contract holders in no other State have any claim against their fund, the deposit being exclusively for the benefit of domestic creditors.

The brief of the S. E. C. states, page 39, that the West Virginia deposit "is clearly intended to secure *all* creditors" and that West Virginia authorities contend that the West Virginia creditors have a preferential interest in their deposit. Both statements are equally inaccurate. The West Virginia respondents contend that the depository law of West Virginia needs judicial interpretation, and that *only* the State Courts of West Virginia can render a *binding and final* decision upon the questions that necessarily arise from its construction; and that

West Virginia officials *can* be guided only by such a State Court decision, and *will* be bound absolutely to abide by it. The West Virginia respondents have no other contentions or intentions in this regard.

That the Courts in West Virginia will make a just decision upon these questions, and will give no undue preference to West Virginia claimants, can be readily discerned from *Brunner* v. *York Bridge Co.*, 78 W. Va. 702, 90 S. E. 233.

On pages 58 and 59 of their brief, petitioners repeatedly refer to rights of "out-of-state-creditors" to participation in local deposits, other than West Virginia, and the S. E. C. brief makes similar refernces and claims for non-resident claimants (pp. 29 and 41); and particularly reference is made to such rights in States as Iowa and Wisconsin, where there is purported to be a surplus of assets. And petitioners claim that all contract holders would be compelled to go into such State Courts to present their claims to any such surpluses that may exist in any State.

But no cases are cited in support of these contentions, and the decided cases are unanimously opposed to petitioners' position.

The decided cases are unanimous in holding that after satisfaction of the claims of domestic creditors, such deposited funds are not subject to the claims of, or attachment by, foreign or "out-of-state" creditors, and any surplus or balance remaining must be returned to the West Virginia Receivers, that is the domiciliary receivers, to be a part of the general assets of the company there, but not a part of the domiciliary deposit fund. *Rollo; Assignee*, v. *Andes Ins. Co.*, 23 Gratt. 509, 29 R. C. L. 108, Sec. 82; *People* v. *Granite State Provident Ass'n*, 161 N. Y. 402, 55 N. E. 1053; *Lewis* v. *American S. & L. Ass'n.*, 98 Wis. 203, 73 N. W. 793; *In re Stoddard* (N. Y.), 144 N. E. 484.

And the domiciliary receivers may pursue and collect such surpluses by ancillary proceedings.

Therefore, the theoretical problems raised by petitioners cannot and will not arise.

We therefore submit that should the West Virginia depository statute be interpreted as above suggested, that at least nine States will have autonomous proceedings in their own State Courts; and that there cannot possibly be any necessity why any of the depository States, including those nine, should be compelled to have their own laws interpreted in a District Court in another State (West Virginia), and be made parties to, and a part of, a proceeding in which they can have no possible interest, and where the other parties thereto can have no possible interest in them; and that in any event, *the problems of law arising by reason of the deposits made in each State as required by the laws and statutes thereof, should be decided only by the State Courts of each State.* And no reasons have been advanced in opposition briefs for a holding to the contrary.

III

THE STATE OFFICIALS OF THE FIFTEEN DEPOSITORY STATES, ACTING UNDER THE GUIDANCE OF EACH OF THEIR RESPECTIVE STATE COURTS AND REPRESENTED BY THEIR ATTORNEY GENERALS AND OTHER PROPER ATTORNEYS, HAVE NOT BEEN SHOWN NOT TO BETTER FITTED TO LIQUIDATE AND DISTRIBUTE THE DEPOSITED SECURITIES THAN IS THE TRUSTEE.

Presuming, as we have throughout this brief, and as the S. E. C. has in its brief admitted (pp. 18 and 43), that

Fidelity cannot be rehabilitated and that liquidation must ensue, there is then presented the single remaining issue, namely, *Who should liquidate the securities held by the depository States, and who should distribute the proceeds thereof to the contract holders?*

In this presumption we are following the opinion of the Circuit Court of Appeals below in no longer entertaining any idea "that illusory hopes of reorganization may be entertained" (R. 2[illegible]), and viewing the situation in the light of that which the Court below so ably stated, "We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of a reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders. Obviously there will be nothing left for the stockholders" (R. 259).

The Court below, in deciding upon this particular issue (R. 262), stated:

> "It has not been and cannot be reasonably contended that the interests of the well secured creditors will be advanced *by interfering with the state officials in the prompt liquidation and distribution of the securities* in their hands. The liquidation in every state in which deposits were made will be subject to the supervision of established governmental departments, as well qualified for the business as the trustee in bankruptcy. There is every reason to believe that the liquidation under their supervision will proceed without needless expense in a careful and expeditious manner so as to save as much as possible for the contract holders. Certainly it would be unjust and unreasonable to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained."

In commenting upon the same issue, under similar circumstances, the Second Circuit Court of Appeals in *In the Matter of Paloma Estates, Inc.*, 126 F. (2d) 72; certiorari denied December 8, 1942, 11 Law Week 3172, stated:

> "Though there might be a reorganization under Chap. X of the Bankruptcy Act, the value of the debtor's property is so small compared to the amount due on the first mortgage that under *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106; only the certificate holders represented by the appellee trustees could have any equity to be preserved. See also, *Consolidated Rock Products Company* v. *Dubois*, 312 U. S. 510. There is nothing to indicate that their interests would or could be better protected in the district court. There *would be increased expense and delay* without any compensating advantages. And it would be inequitable to subject the certificate holders to such expense in time and money when their security, already inadequate, is being well applied to subserve their best interests in the prior state court proceedings. See, *Chapman Bros. Co.* v. *Security-First National Bank*, 111 F. (2) 86."

Respondents contend that the State Court proceedings will not only afford a more rapid means of liquidation and distribution, but a less expensive method. That Chapter X proceedings are slow and lengthy, and are usually very expensive, is recognized not only by the Courts, but by the writers on this subject. (See brief of Attorney General of New York in the *Marine Harbor* case.) In New York Legislative Document No. 87, on the legislative investigation of the Prudence Bonds issue, it is stated: "In a reorganization under 77B, the proceedings were complicated and extended over a long period of time." Specific large fees paid in cases to many parties at the expense of certificate holders were cited.

Mr. Benjamin Wham, writing in 25 Virginia Law R. 389, states at 391:

> "Very likely [Chapter X] proceedings will take more time due to the increased numbers of petitioners, and it may be more expensive, and at least there will be more petitions for compensation * *. The provisions with reference to allowance of fees and costs are designed to invite active participation of the creditors and stockholders. It sounds like 'come and get it'."

Mr. James N. Rosenberg, also writing in 25 Virginia Law R. at 157-8 states:

> "The subject of expenses of administration gives food for thought * * *. The Chandler Act opens a new door. Designed to democratize the proceedings and encourage investors' participation, it permits the Court to compensate even those who submit mere suggestions or objections * * *. The flood gates are now open."

In 52 Harvard Law R. 1349 at 1350 it is stated that "the Chandler Act, subordinating the desire to minimize expense to the ideal of universal protection * * presages an increase in the costs of reorganization," and in note 8, citing the hearings before the House Committee of the Judiciary on HR-6439, 75th Congress, 1st Sess., p. 368, states that in the ordinary case it has been estimated the services of a competent disinterested trustee would cost $25,000 a year with a like sum for counsel. At p. 1353 the article states: "Care must be exercised lest the affairs of a hopelessly insolvent concern be dissipated in futile attempts at reorganization."

Liquidation Should Promptly Ensue, and in the State Court Proceedings

In *Reading Hotel Corp.* v. *Protective Committee*, 89 F. (2d) at 53, the Court held that the creditors had the

right to foreclose when their lien exceeded the value of the property securing it, and there was no equity for stockholders, and held that the possibility of creating an equity for stockholders in years to come is not sufficient interest to permit them to compel the lienholders to wait.

This Court in *Tennessee Publishing Co.* v. *American National Bank*, 299 U. S. 18, 81 L. Ed. 13 held: "However honest in its efforts the debtor may be and however sincere its motives, the District Court is not bound to clog its docket with visionary or impractical schemes for resuscitation."

And Mr. Justice Douglas, speaking in 42 Yale Law J. at 592: "It seems moreover, not too extravagant to hope that bankruptcy can be viewed against the background of the condition with which it deals; that long term planning for the many separate problems can be made • • •. Such planning leads directly to a consideration of division of control and responsibility *between State and nation* as respects these various problems and of allocating or dividing between the two bankruptcy power as an incident of that control."

In 27 Cornell Law Q. at 373, Mr. Ganard Glenn, author of books on liquidation, states: "If a concern cannot be reorganized the older remedy of liquidation • • • remains and always will." And as Judge Jerome Frank stated at p. 349, speaking then as head of the S. E. C. and for it, "It would be amazing, therefore, if our construction were right every time."

And in *First Nat. Bank* v. *Flershem*, 299 U. S. 504, at 515, 78 L. Ed. 46, this Court in Note 7 stated, that all the cases in which it has exercised its power to aid in reorganization upon the ground of insolvency dealt with insurance or other public utilities where continued opera-

tion of the property and preservation of its unity seemed to be required in the public interest.

And in *International Shoe Co.* v. *Pinkus*, 278 U. S. 261, 73 L. Ed. 321, this Court held:

> "The general rule is that an intention wholly to exclude State action will not be implied unless when fairly interpreted an Act of Congress is plainly in conflict with State regulation in the same subject."

And in the *Marine Harbor* case (supra) this Court held:

> "While the pendency of prior proceedings in state or federal courts does not bar the filing of a petition under Ch. X (Sec. 256), Congress in effect directed the bankruptcy courts not to approve petitions under Ch. X in such cases unless it appeared that the interest of creditors and stockholders would not be best subserved in the prior proceedings. And it put the *burden on the petitioner* to make that showing."

In *California Prune, etc. Co.* v. *Cate American Co.*, 60 F. 2d 789 at 790, the Court held: "The Act itself discloses it was the intent of the Legislature to provide a procedure peculiarly adapted to the State Courts of California; and in view of many of the provisions of the Act, it would be difficult if not impossible to harmonize it with federal law and procedure."

And as Mr. John Gerdes says in 18 N. Y. U. Law Q. Rev. at 313: "Paternalistic reorganization of insolvent companies by governmental agencies runs counter to fundamental and deep-seated American concepts."

On Oct. 22, 1942, Waring J. (D. C. S. C.) held in *In re Unity Life Ins. Co.*, 11 Law Week 2361: "If the

Court comes to the conclusion that there is no chance of a reorganization and that liquidation is the only expectation, the petition should be refused."

In its brief in the *Marine Harbor* case in which it appeared, the S. E. C. stated, p. 13: "Chapter X is designed for the *permanent rehabilitation* of a corporate debtor while safeguarding the interests of security holders." See also p. 27.

In Chapter X proceedings it is necessary to have fees paid the trustee, the trustee's attorney, the debtor's attorney, committees of creditors and stockholders, and their attorneys, appraisers, masters and probably a few others.

In the instant State Court proceedings there were no creditors protective, or stockholders, committees, no appraisers or masters, no debtors' attorney in most proceedings, and salaried State officials instituted the majority of the proceedings, by their salaried Attorney Generals.

Therefore, liquidation and distribution can better be had in the State Court proceedings, under the guidance of the State officials.

The Salutary Safeguards of Chapter X

We have earlier herein set forth the reason for our belief that under the ruling in the *Marine Harbor Properties* case it is unnecessary to determine whether the salutary safeguards of Chapter X exist in the prior pending State Court proceedings; that which is hereinafter stated is in answer to the brief of petitioners and upon the presumption that this Court *may* hold that it is necessary to investigate these safeguards.

Under the decision of this Court in *Securities and Exchange Commission* v. *United States Realty Co.*, 310 U.

S. 434, 84 L. Ed. 1293, and the dissenting opinion of Judge Frank in the *Marine Harbor* case, 125 F. 2d 296, there are apparently three main safeguards contained in Chapter X, namely, that the S. E. C. be permitted a supervisory power in the proceedings; that a fair and equitable, and at the same time feasible, plan be presented; and that the creditors be given full information before they are required to act with reference to the reorganization.

However, petitioners have suggested a number of other and further reasons why Chapter X proceedings are superior to those in State Courts, which are: (1) the proceedings in the State Courts are not under any reorganization statutes; (2) the creditors should be protected from the old management group; (3) the need of advisory reports on the feasibility of a plan, and whether it is fair and equitable; (4) a report to the creditors under Section 175 giving the creditors information as to their interests; (5) an independent study by the S. E. C. to exclude collusive programs; (6) a requirement that the plan be approved by the Court prior to submission to the creditors; (7) an independent appraisal of the assets of the Debtor by the S. E. C.; (8) the retaining of jurisdiction by the reorganization Court; (9) the lack of jurisdiction in any State Court to review all of the liabilities of Fidelity or appraise all its assets; (10) Fidelity's business can only be administered in the Bankruptcy Court because it has national jurisdiction; (11) the creditors in State Court will be at the mercy of those having charge of the several State proceedings; (12) several State Courts threatened distribution without a judicial determination of the rights and interests of out of State creditors to participate in the local deposited assets; (13) the rights of participation among and between the contract holders must be judicially determined; (14) there will be balances remaining in several States after

their local contract holders are paid from their deposited funds, and all of the contract holders will have to file a claim against these remaining balances.

Discussing these problems in the above order, with reference to the three main safeguards, Congress enacted Section 25 of the Investment Company Act of 1940 and Section 29 of that Act, dealing with reorganization and bankruptcy of face-amount certificate companies, after enacting Chapter X. As above discussed, the S. E. C. may participate in these proceedings, may render advisory reports therein, and has such supervisory control as the Congress believed and determined it was necessary that it should have over such companies.

The terms "fair" and "equitable" and "feasible" are words of art, which mean that any plan adopted must comply with the full priorities rule of the *Boyd* case. *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. at 115. It is agreed by petitioners (Brief p. 40), as well as respondents, that the stockholders have no further interest in the proceedings, even though this present controversy is and has been carried on and this present hearing had by virtue of the activities of the stockholders alone. In no State Court proceeding will the stockholders be given any more rights than they would have in the federal proceedings, and their activities in fighting the State Court proceedings indicate their knowledge of this. The deposited funds will be distributed to the contract holders rightfully entitled thereto, under the State laws as interpreted by the State Courts. Since the only plan is liquidation and distribution, there is apparently no need for any further determination of its fairness and feasibility.

The State Court Receivers and the authorities in the various States were in communication with the contract holders until that was further prohibited by injunction by

the District Court. The thousands of letters written by contract holders to the State Court Receivers (R. 320), the mass meeting of the contract holders at Wheeling (R. 398-403), and the fact that one receivership suit was brought as early as 1938, together with the fact that contract holders are and have been represented by committees in the instant proceedings, all indicates contract holders are alert, and have been receiving information concerning the affairs of the company.

Of course, Section 167(5) of Chapter X provides that the Trustee "shall, at earliest date possible, prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, in such form and manner as the judge may direct, to the creditors," etc.

On October 10, 1941, the Trustee prepared and submitted to the Court a partial report under this section, and on April 13, 1942, a further partial report. To date, these reports have not been submitted in any form to the contract holders.

No criticism is meant or implied in the Trustee's action in this regard. The reports are extremely voluminous, contain many charts, and detailed financial statements. They undoubtedly took much time to prepare, even though the Trustee had available the data prepared by the State Court Receivers.

And it would appear, since the Trustee has not done so, that it was impossible to boil this material down into a reasonably sized statement for the contract holders. Also, the expense of printing and mailing such a statement to over 80,000 persons is for practical purposes, prohibitive, and we believe the Trustee's judgment in not doing it was sound.

But, this very section, 167(5), is supposed to be one of the main safeguards found in Chapter X which will not be present in any State Court proceeding, and therefore a substantial reason for preferring Chapter X proceedings, that is, that the creditors may act only upon an informed knowledge.

This safeguard, therefore, is not one to be considered by this Court, because since the Trustee has not given this information to the contract holders in the year and a half it has held office, presumably, for the sound reasons above stated, it will not do so in the future.

Therefore, the contract holders will have at least as informed an opinion in State Court proceedings as they would under Chapter X proceedings.

With reference to the points raised by petitioners:

(1) It is true that State proceedings are not under reorganization statutes, but any necessary reorganization could have been performed in the proceedings instituted in State Courts, either by virtue of the statute under which they were brought, or by virtue of the general equity powers of the Courts. Let it be remembered that with few exceptions every insolvent insurance corporation in the United States has been reorganized through these same statutory and general equity proceedings in the State Courts by State officials.

However, each of the State statutes or their general laws do have a provision for *liquidation* of the State deposits. The respondents here believe the question of reorganization statutes is beside the point, and since they have adequate legal machinery for liquidation and distribution, that is all that is necessary in this case.

(2) It seems anomolous that the petitioners who here represent the old management group of the company would, on page 52 of their brief state: "Chapter X was

designed to provide safeguards for the creditors and stockholders against the superior knowledge and advantageous position of the management." The State officials are and were doing that very thing, the West Virginia Receivers having discharged the management group immediately after taking charge of the company under their appointment, and it is that management group so discharged which instituted the Chapter X proceedings. It is now argued that the proceedings are needed to protect the contract holders from that management group who raise that question.

(3) The management group of the company represented by petitioners can, under Section 25(b) of the Investment Company Act, request an advisory report of the S. E. C. in State Court proceedings, which they claim is needed.

(4) We will later discuss the report to creditors showing their interest, but it can be here stated that that has been done already in West Virginia and some of the other State Court proceedings, and to date has not been attempted in the Federal proceedings.

(5) The S. E. C. not only has made a study for several years of this particular company, but has submitted a printed book to Congress (Ex. 6) containing the results of that investigation, and has submitted other reports to Congress containing information upon investment companies, including face-amount certificate companies generally. Any collusive or fraudulent program in State Court proceedings can be enjoined by the S. E. C. under Section 25(c) of the Investment Company Act.

(6) It is again anomolous for the Debtor to raise, on page 53 and on page 57, the question that there is no *statute* which requires the plan to be submitted to the creditors only after it has been approved in State Courts. A petition was filed in the West Virginia State Court

praying that no plan of reorganization be submitted to the contract holders without notice and right to be heard by that petitioner and her counsel. (Ex. 70-b of the case at bar, not printed).

The Circuit Court of Kanawha County, on May 26, 1941, after a hearing on that petition, in section 2 of that order (Ex. 70-c, not printed), ordered:

> "The form and manner of submission by such Receivers to contract holders of any plan of reorganization and rehabilitation of defendant, or any information concerning same, shall be submitted to this Court for approval before such submission, after notice thereof to petitioner and other contract holders who may at the time be parties to this suit, and after hearing upon such notice."*

Therefore, the question raised in this record by petitioners was fully answered for them in the State Court proceedings.

(7) Debtor's assets have been appraised by innumerable auditors and accountants prior to the institution of these proceedings by the Debtor, and at the request of the S. E. C., and have been and are before this Court in a number of financial statements.

(8) Petitioners contend on page 54 of their brief that Chapter X is superior to the prior State proceedings because "the reorganization court has jurisdiction to retain supervision for the purpose of seeing that the plan is fully and fairly carried out."

However, the Second Circuit Court of Appeals in *In re Flatbush Avenue-Nevins Street Corporation*, decided January 8, 1943, 11 L. W. 2544, opinion by Judge Jerome

*See also letter of Circuit Court Judge, Appendix Part VI.

Frank, holds that after the plan has been approved by the reorganization court it has no further jurisdiction in the matter, and that Congress did not intend the bankruptcy court, after approval of a plan under Chapter X, should "have power to remain a wet nurse to the reorganized company. A bankruptcy court cannot obtain that power merely by inserting a provision reserving jurisdiction."

The State Courts can retain jurisdiction of the proceedings before them as long as there is any necessity so to do, and the State authorities are required by their own laws to maintain supervision over these companies until the proceedings are finally ended by complete distribution.

(9) It is not true that no single State Court has jurisdiction of Fidelity to review all of its liabilities and appraise its assets. This is a part of the function of the Auditor of West Virginia, and he has done that, and the State Court Receivers prepared complete lists of the assets and liabilities and filed them in the West Virginia State Court proceedings, which were in turn filed by the Federal Trustee herein as part of its required reports.

(10) Petitioners' contention that Fidelity's business can only be administered in the Bankruptcy Court under Chapter X, is wholly without merit. Congress, in enacting Sec. 25 of the Investment Company Act specifically provided legislation for reorganization proceedings in Courts other than the Bankruptcy Court.

Also, the Securities Exchange Commission, in its report to Congress on the Study and Investigation of the Work, etc., of Protective and Reorganization Committees, Part VIII, at p. 309, states: "Large numbers of reorganizations do not come within the jurisdiction of the federal courts. *Some take place in state courts or under supervision of state agencies.* * * * We do not believe it

feasible to attempt to bring such reorganization completely under either judicial or administrative supervision by the federal government."

(11) While it may be true that in the State Court proceedings contract holders will be at the mercy of those in charge thereof, nevertheless those in charge are the State's officials, acting in their official capacity, and who were elected to their offices by those contract holders in their own States. We submit that those persons will be as careful of the rights of the contract holders in their States as would be a Federal corporate trustee, not selected by the creditors, but appointed by the District Court in a district many hundreds of miles from the location of the contract holders.

(12) It is true that the several States not only threaten but intend to distribute the assets held in those States, but it is not true that this is to be done wihout judicial proceedings. On the contrary, liquidation and distribution by the States will be made only in the State Courts thereof. Petitioners, as stated hereinbefore, failed to cite any authority whereby out of state creditors had any rights at all in the funds deposited in trust in a State for the benefit of the contract holders of that State alone, and therefore, there is no question which can arise under any decided authority concerning the rights of such out of State persons.

(13) As hereinbefore stated, it will be necessary for the Courts of each State to determine among the contract holders of their own State who, under the depository laws of that State, are entitled to participate in the deposited assets, and naturally this question will have to be decided before a distribution is made. The petitioners and the S. E. C. advance no reasons against the argument hereinbefore made that the determination of such

questions of State law should only be made by the State Courts in the State which enacted those laws.

(14) We have hereinbefore set forth the cases which hold that balances or surpluses remaining after distribution in any State must be returned to the West Virginia Receivers, who are the domiciliary Receivers, and that no out of State contract holder has any right to go into the Courts of the State having such surplus or balance and make any claim thereto. See also 29 R. C. L. 108 s. 82. The petitioners cite no authority to substantiate their position.

Proceedings Subsequent to Circuit Court of Appeals Decision.

As shown by the record, shortly after the decision of the Circuit Court of Appeals (R. 276, 282) the State officials, their Attorney Generals, State Court Receivers, and their attorneys, for each of the fifteen depository States, met in Charleston, West Virginia, for the purpose of exchanging information and to work out cooperatively their mutual problems, particularly the problems of liquidation and distribution.

Counsel for most of the parties herein, except the S. E. C., had a conference before Judge John J. Parker, of the Court below, prepared and had entered by the Court, on July 22, 1942. (R. 268), an agreed order permitting the servicing of the deposited funds by the State officials, permitting the necessary liquidation of securities and providing for the sending out and receiving of proofs of claims by the State authorities, and other administrative work looking to the future distribution of the assets.

Wisconsin, prior to the institution of the Chapter X proceedings, had sent out its proofs of claim and had received and filed them. In the Tennessee proceedings, a report on claims has been filed with the Court.

Under the order of July 22, the State authorities worked out a uniform proof of claim to be sent the contract holders and have laid tentative plans for liquidation of the deposited securities, under the advice of State officials, so that there will not be competition between the States in the liquidation, and in order to obtain the highest price possible for the deposited assets. At the conference in Charleston, Auditor Sims of West Virginia was chosen as head of an advisory committee for the liquidation of securities, and has requested the heads of the Insurance Departments of eleven other States to act with him on that advisory committee, and has received replies from each of them that they will act in such capacity. Those persons are the Security Commissioners or heads of the Departments of Insurance of the States of Connecticut, Illinois, Indiana, Massachusetts, Michigan, Virginia, Minnesota, Missouri, New York, Ohio and Pennsylvania.

Certainly this advisory group, acting together with those State officials who are directly in charge of the securities departments and who have direct supervision over the liquidation of Fidelity, and acting under the judicial guidance of the respective State Courts in fifteen States, are equally as capable as is the Federal Trustee of liquidating the deposited securities.

The uniform proof of claim tentatively agreed upon for use in this case has been used by West Virginia and Missouri, and is in the process of being used in Ohio, Delaware, Tennessee and Indiana, and other States have only refrained from continuation of their administrative procedure in this respect pending the final determination of this case by this Court. Copies of these uniform proofs of claims are contained in the Appendix, Part VIII. They answer many of the questions which petitioners have raised and, together with the letter of transmittal to the contract holders, were worked out with the cooperation and aid of the attorneys for the Federal Trustee.

They give to the contract holders all of the information concerning his claim which the company has in its books and records. The West Virginia Receivers, acting under the Auditor of West Virginia, as well as in their own capacity, have sent out proofs of claim, over sixteen thousand in number, to all of the West Virginia contract holders and to all of the contract holders in those States which have no deposit and which will look primarily to the West Virginia fund for payment. The work of receiving the returns and filing them has been practically completed at this time.

As will be noted, the form is very simple, and mechanically arranged so that one typing fills in the blank spaces on both the letter of transmittal and the proofs of claim.

All information as to the claim is filled in by the official sending out the claims, including the amounts paid in by the contract holder, the cash surrender value, loan amount (if any), and net cash surrender value; the contract owner need only fill in his residence at the time of the purchase, and his residence on April 11, 1941, the date of receivership, verify the correctness of the claim, swear to it, and return it. Missouri has sent out and received its proofs of claim on these forms, and has used the tentatively agreed upon form for proof of claim over against West Virginia.

Each of the depository States is expected to do as has Missouri,—send out two proofs of claim forms, filled in with the information from the company's books as to the respective claim of that contract holder, both of which claims will be returned to the officials of the State sending them out. One form will be a proof of claim against the deposited fund in that State; the other will constitute a claim over against the West Virginia fund in the event the contract holder does not receive full payment in his own State and has a claim against the assets in West Vir-

ginia. These will later be sent en masse by the State officials in the various States, together with the amount and percent of total claim each contract holder receives from his domestic deposit, to the Receivers in West Virginia, who will accept them as proper proofs of claim, subject, of course, to a decision as to their rights against the assets in West Virginia, which must be determined by the West Virginia State Court. Surpluses, if any exist in any State, will be sent to the West Virginia Receivers.

No objection to this procedure has been made by any contract holder, and it apparently resolves all of the questions which petitioners and the S. E. C. attorneys have raised as to the necessity of filing many proofs of claim.

Therefore, the remaining matters to be performed in the State proceedings are extremely limited. Those States which have not completed sending out and receiving proofs of claim will proceed to do so. The various State officials and Receivers acting cooperatively together, but under the jurisdiction of their own State Courts, and with the advice and help of the insurance Commissioners of many States, will liquidate the deposited securities. *After the necessary legal determination* as to amount each contract holder shall receive is had in each of the State Courts, a distribution of the proceeds will be made to those properly entitled thereto. West Virginia will be in charge of all contract holders in that State, and in all States having no deposit; all contract holders not receiving the full amount of their claim from their respective State deposits will settle all of their problems in this regard in the West Virginia State Court by claims over against the West Virginia assets.

It is, therefore, respectfully submitted that the officials of the fifteen States acting under their State laws and under the guidance of their Courts are capable of per-

forming these acts, as shown by their actions in the past; that they are capable of working cooperatively together in the future for the best interests of the contract holders, and will do so, and should be permitted so to do.

IV

REPLY BY THE ACTING ATTORNEY GENERAL OF WEST VIRGINIA TO THE S. E. C. BRIEF

While all other parts of this brief have been written jointly on behalf of the West Virginia respondents, this particular reply (Part IV of this brief) is submitted solely by the Acting Attorney General of West Virginia.

The S. E. C. brief, page 30, states that the Circuit Court of Appeals below, in reaching its conclusion that the State proceedings better subserve the interests of Fidelity's contract holders, failed to give due weight to a number of factors which establish the superiority of Chapter X proceedings.

The first of those factors is that it is peculiarly salutary to utilize the provisions of Chapter X to investigate and prosecute possible causes of action for the benefit of the Debtor's estate (p. 31), and that problems of venue and jurisdiction are major obstacles to civil suits at the instance of all State officials but those in West Virginia, and these latter are unsuited to the purpose.

This question of suitability of the West Virginia respondents will be discussed first.

Certain statements are made on page 33 of the S. E. C. brief that counsel for the West Virginia Receivers were Fidelity's regular counsel and one of them was under indictment. The Solicitor General's office has advised

that these statements were inadvertently placed in the brief, are not supported by the record, and it is the desire of that office that the statements be disregarded and not considered by this Court.

The correct fact is that counsel for the West Virginia Receivers had been local (R. 1184) and special (R. 1167) counsel for Fidelity in recent years. The Circuit Court of Kanawha County, West Virginia, by proper order entered on April 11, 1941, authorized and approved employment of the counsel for the West Virginia Receivers, after a petition therefor had been presented by the Receivers (R. 574). That employment had the full consent and approval of the Auditor of West Virginia, and was undertaken at the request of, and with the express consent, recommendation and approval of, the then Attorney General of West Virginia.

The S. E. C. brief states that the position of the West Virginia respondents does not give promise of as adequate a prosecution of possible causes of action, against Fidelity's management (Brief, p. 33) for the benefit of the contract holders, as would be made by the Trustee, because one Receiver is a law associate of, a former Fidelity director, Mr. Arthur B. Koontz.

In fairness to Mr. Koontz and that Receiver, this separate answer is made. Mr. Koontz was a director, with one qualifying share of stock placed in his name (R. 1166), who lived and practiced law in Charleston, West Virginia (R. 1134), two hundred miles from Wheeling, where the home office of Fidelity was located. Mr. Koontz is a respected member of the bar in West Virginia.

In answer to a question as to whether he would feel free and unhampered in any attempt that might be made to recover funds due Fidelity from any party whom it was deemed advisable to proceed against (R. 1195), Mr.

Koontz stated that if his firm could not go ahead and prosecute the suit fully, they would step aside and the Attorney General would appoint somebody to go ahead and prosecute the suit, but that he, Mr. Koontz, could think of no personal or business association "that would retard any affirmative action on our part." (R. 1198.)

The propriety of the appointment of that same West Virginia Receiver was raised in the District Court, and because thereof, the Judge of the Circuit Court of Kanawha County, West Virginia, who made that appointment, wrote a letter to the District Judge, giving his reasons therefor, and explaining the entire situation. This letter is in evidence, and is set out in the Appendix Part VI.

The same issue was raised in the Circuit Court of Appeals below, which considered the matter, and stated in its opinion (R. 262):

> "• • • and the suggestion is made that the state court receivers would not be likely to proceed diligently against the directors if an investigation should disclose the existence of some liability on their part to the corporation's creditors. No specific facts are set out in this respect, but if such facts exist and the necessity for a proceeding against the directors should arise, we have no reason to suppose that the state court will not do its full duty in the premises."

Not only does the evidence fail to disclose any such probable causes of action, but the Trustee, although it has held office for one and two-thirds years, has yet to make any report of any purported liability or cause of action against any officer or director; nor has the S. E. C. produced any such evidence in this case, although it investigated the affairs of the company for over four years;

and no contract holder has made any such claim or instituted any action thereon.

The statements in the S. E. C. brief overlook the fact that the S. E. C. and the Trustee are supporting in this Court the position and contentions of the Debtor, and that it is the officials who comprised Fidelity's former management, who were instrumental in instituting the Chapter X proceedings, who testified in the District Court in Debtor's behalf, who have opposed Auditor Sims and the West Virginia State Court proceedings, and who are carrying on this present controversy against the respondents. There are no reasons given why the West Virginia respondents would not properly perform their required duties in the premises equally as well as the Trustee and the S. E. C., *if* there were proper need to act against those persons.

Also, Mr. H. Isaiah Smith, one of the two West Virginia State Court Receivers, and a respondent herein, has been employed by the Trustee ever since its appointment, as the active executive head and agent of the Trustee in charge of Fidelity's affairs at its home office in Wheeling.

The testimony of Auditor Sims indicates the fearless and impersonal manner in which he has heretofore discharged his duties concerning Fidelity; the Attorney General of West Virginia is counsel for the Auditor, the plaintiff in the West Virginia State Court proceedings, and the writer feels it will be presumed that whoever that Attorney General may be at the time action is needed will fully perform his duties in the premises.

Disregarding the question of suitability, there are several reasons why the contentions of the S. E. C. are without merit.

The alleged causes of action are those by contract

holders against the former management or directors, and there is no claim alleged to exist against such persons on account of the Debtor or its estate alone. For this reason, neither the Receivers nor the Trustee would have any right to represent contract holders in any such suits, but if such rights of action existed, they would be solely the property of the individual contract holders.

Next, the Supreme Court of Appeals of West Virginia, on October 14, 1941, decided, in the case of *Inter-Ocean Casualty Co.* v. *Leccony Smokeless Fuel Co. et al.*, 17 S. E. (2d) 51, at 53-4:

> "* * * In this state it is well settled that the creditor of a monied corporation cannot maintain an action at law against the directors thereof for simply nonfeasance of duty to the corporation or fraud in its management or mismanagement in the disposition of the money or property of the corporation in the absence of an active intent to deceive or defraud the plaintiff. *Zinn* v. *Mendel*, 9 W. Va. 580."

And there is no evidence in this case of any "active intent to deceive or defraud" the contract holders by any director or officer of Fidelity.

Apparently it is the S. E. C. contention that such rights of action could be brought in the reorganization proceedings, particularly if the causes of action inured to the benefit of the Debtor. There is no citation of authority in support of this position. However, in the Circuit Courts of Appeals of the 3rd, 5th, 7th, 8th and 9th Circuits, actions such as those contemplated were instituted against directors on behalf of the debtor in 77-B proceedings, and in every circuit it was held that such causes of action were not a proper part of reorganization

proceedings, and for jurisdictional reasons could not be instituted in the Federal Court. Those cases are:

Bovay v. *Byllesby & Co.*, 88 F. (2d) 990 (5th C. C. A.).

In re Standard Gas & Electric Co., 119 F. (2d) 658 (3rd C. C. A.).

Brockett v. *Winkle Terra Cotta Co.*, 81 F. (2d) 949 (8th C. C. A.).

Thompson v. *Terminal Shares, Inc.*, 104 F. (2d) 652 (8th C. C. A.).

U. S. v. *Tacoma Oriental S. S. Co.*, 86 F. (2d) 363 (9th C. C. A.).

In re Prima Co., 98 F. (2d) 952 (7th C. C. A.); Certiorari denied 305 U. S. 658.

The theory upon which these cases were brought was that the right of action against the directors or former management was an asset of the debtor over which the Court had jurisdiction, and that it was in reality an *in rem* proceeding.

The *Bovay* case was one wherein it was claimed the directors falsely obtained money from the debtor. The Court held it was an action *in personam* and process served outside the territorial limits of the District Court was ineffective to acquire jurisdiction, as the claim was not *in rem*.

In the *Standard Gas* case, of the same nature, the same ruling was made, and also that a suit against a resident director would not lie, as there was no diversity of citizenship; that the Court's jurisdiction outside its own territory was only *in rem*, and therefore no valid service could be had on non-resident directors.

In the *Brockett* case it was held that charges of mis-

conduct against officers and directors can not properly be determined in a reorganization proceeding.

There is only one director within the territorial jurisdiction of the District Court in this case, only a few in West Virginia, and the rest live elsewhere. Such a suit, even if there were grounds, would fail in the Chapter X proceedings.

Again disregarding the question of suitability, if the causes of action belonged to the Debtor and it was necessary to institute suit thereon outside of the Chapter X proceedings, either within or without the State of West Virginia, then the State Court Receivers, themselves or through ancillary receivers, would legally be as capable of prosecuting these causes of action as would the Trustee, for in either event the Trustee or Receivers would have to proceed in the proper State or Federal Court wherein the particular defendant lived in order to obtain proper service upon that defendant for an *in personam* action.

Therefore, no substantial reasons, grounds, or decided cases have been advanced in the S. E. C. brief that would sustain petitioners' burden of proving the superiority of Chapter X proceedings over those already pending in the State Courts.

V

THE JURISDICTION OF THIS COURT HAS BEEN IMPROPERLY INVOKED

The petitioners herein were without valid right or authority to file Debtor's petition for writ of certiorari.

It is submitted that the Trustee is not and should not be concerned with the merits of a petition filed under Chapter

X of the Bankruptcy Act, or with its dismissal, and has no right to partake in the controversies thereon.

Loomis v. *Gila County*, 103 F. (2d) 312, Certiorari denied, 307 U. S. 643.

The S. E. C., who is named a respondent herein, but who is in substance a petitioner, "may not appeal or file any petition for appeal in any such proceeding." Sec. 208, Ch. X.

It is further submitted that since the District Court held invalid the original corporate meeting of June 3, 1941, purporting to authorize the filing of the Debtor's petition on June 6, 1941, that thereafter there was no valid or lawful corporate meeting validly ratifying the filing of the petition, nor could there have been such lawful and valid ratification, since the directors were forbidden to serve by Section 9(a) of the Investment Company Act, they having been enjoined in the Detroit suit in 1938 (Ex. 6, p. 257), and no exemption having been granted them upon their application to the S. E. C. therefor (Ex. 88, R. 766-67).

Also, it is submitted that since there was no corporate meeting authorizing the filing of the petition for writ of certiorari in the case at bar, the purported authorization acted upon was invalid and improper. Further, the actions of those officers and directors, who purported to act in Debtor's behalf throughout these proceedings, were such that the Debtor's petition was not filed in good faith within the generality of the meaning of that term. Sec. 146, Chap. X.

Lastly, since the only assets within the territorial jurisdiction of the District Court were those deposited with the *State* of West Virginia, and since under the Eleventh Amendment the Court has no control or jurisdiction over those funds, and since the principal place of

business of Fidelity was in Wheeling, in the *Northern* Federal District of West Virginia, these proceedings in the Southern District of West Virginia must fail for lack of proper venue under Sec. 128 of Ch. X.

The facts upon which the above contentions are based, and the citations of law and authorities which sustain these assertions, and the arguments thereon, are fully set forth in the West Virginia Respondents' Brief In Opposition To The Petition For Writ of Certiorari:

Realizing that the broad aspects of Section 146, particularly Sections 146(3) and (4), are now before this Court, and that the decision herein in all probability will not be based upon the more narrow issues under this jurisdictional heading, we, therefore, do not herein repeat those facts, citations of law and argument thereon, but refer the Court, if it deems the matter of importance, to our brief in opposition to certiorari, pages 5 to 10, 11 to 13, 17 to 26, 41 to 52, and 55-56 inclusive.

CONCLUSION

For the reasons set forth above, your respondents, the Auditor and ex officio Insurance Commissioner of West Virginia, and the West Virginia Receivers, hereby respectfully submit that the decision, holding and judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

IRA J. PARTLOW,
Acting Attorney General of West Virginia,

KOONTZ & KOONTZ,
Attorneys for West Virginia State Court Receivers,

J. CAMPBELL PALMER, III,
Of Attorneys for West Virginia State Court Receivers,

Counsel for the West Virginia Respondents

APPENDIX

PART I

STATUTES INVOLVED

United States Statutes

The following sections of Chapter X of the Bankruptcy Act:

Sec. 130. Every petition shall state . . .

(7) The specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act.

Sec. 141. Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Sec. 144. (Printed page 64 of Petitioners' Brief).

Sec. 146. (Printed page 64 of Petitioners' Brief).

West Virginia Statutes

The following sections of the Code of West Virginia, Ch. ---, Art. ---, Sec. ---:

12-5-2:

Treasurer Custodian of Securities; Charges to Companies for Care, etc., of Securities.—The treasurer of this state, unless otherwise expressly provided by law, shall be custodian of all securities belonging to the state of West Virginia or by law required to be deposited with the state or held in legal custody by the state, and all departments of this state, commissioners or agents of the

state, who hold any such securities, shall transfer and deliver the same to the state treasurer to be kept and held by him as legal custodian thereof until released in the manner provided by law.

The board of public works may by formal order of record fix fair and reasonable charges for the care, custody, exchange and substitution of securities deposited by insurance companies and companies issuing annuity contracts, and such charges shall be collected from such companies by the state treasurer and by him deposited in the state fund general revenue: Provided, however, That no such charge shall be made against any such company having securities of the par value of less than three hundred thousand dollars deposited hereunder.

Constitutional Provisions Involved

Constitution of the United States:

Eleventh Amendment.—The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

PART II

STATUTES DISCUSSED

United States Statutes

The following chapters and section of the Bankruptcy Act:

Chapter II.—The Bankruptcy Court shall have the power to:

Sec. 2a(5). Authorize the business of bankrupts to be conducted for limited periods by receivers, the marshals, or trustees, if necessary in the best interests of the es-

tates, and allow such officers additional compensation for such services, as provided in section 48 of this Act.

Sec. 2a(7). Cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate, whenever under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest.

Chapter X—

Sec. 236. If no plan is proposed within the time fixed or extended by the judge, or if no plan proposed is approved by the judge and no further time is granted for the proposal of a plan, or if no plan approved by the judge is accepted within the time fixed or extended by the judge, or if confirmation of the plan is refused, or if a confirmed plan is not consummated, the judge shall—

Sec. 236(1). Where the petition was filed under section 127 of this Act, enter an order dismissing the proceeding under this chapter and directing that the bankruptcy be proceeded with pursuant to the provisions of this Act; or

Sec. 236(2). Where the petition was filed under section 128 of this Act, after hearing upon notice to the debtor, stockholders, creditors, indenture trustees, and such other persons as the judge may designate, enter an order either adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with pursuant to the provisions of this Act, or dismissing the proceeding under this chapter, as in the opinion of the judge may be in the interests of the creditors and stockholders.

Former Section 77-B—

(c) Upon approving the petition or answer or at any time thereafter, the judge, in addition to the jurisdiction

and powers elsewhere in this section conferred upon him, * * * (8) if a plan of reorganization is not proposed or accepted within such reasonable period as the judge may fix, or, if proposed and accepted, is not confirmed, may, after hearing, whether the proceeding be voluntary or involuntary, either extend such period or dismiss the proceeding under this section or, except in the case of a railroad or other public utility or of a debtor which has not been found by the judge to be insolvent, direct the estate to be liquidated, or direct the trustee or trustees to liquidate the estate, appointing a trustee or trustees if none shall previously have been appointed, as the interests of the creditors and stockholders may equitably require; * * *"

11 U. S. C. A. 203(i) (1)—

The court shall confirm the proposal if satisfied that (1) it included an equitable and feasible method of liquidation for secured creditors and of financial rehabilitation for the farmer; * * *

The following sections of the Investment Company Act of 1940:

Sec. 3 (a) (2)—

When used in this title, "investment company" means any issuer which—

* * *

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; * * *.

Sec. 9 (a) (2)—

It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member

of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company:

* * *

(2) any person who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security; * * *

Sec. 25 (b)—

The Commission is authorized, if so requested, prior to any solicitation of security holders with respect to any plan of reorganization, by any registered investment company which is, or any of the securities of which are, the subject of or is a participant in any such plan or if so requested by the holders of 25 per centum of any class of its outstanding securities, to render an advisory report in respect of the fairness of any such plan and its effect upon any class or classes of security holders. In such event any registered investment company, in respect of which the Commission shall have rendered any such advisory report, shall mail promptly a copy of such advisory report to all its security holders affected by any such plan: *Provided*, That such advisory report shall have been received by it at least forty-eight hours (not including Sundays and holidays) before final action is taken in relation to such plan at any meeting of security holders called to act in relation thereto, or any adjournment of any such meeting, or if no meeting be called,

then prior to the final date of acceptance of such plan by security holders. In respect of securities not registered as to ownership, in lieu of mailing a copy of such advisory report, such registered company shall publish promptly a statement of the existence of such advisory report in a newspaper of general circulation in its principal place of business and shall make available copies of such advisory report upon request. Notwithstanding the provision of this section the Commission shall not render such advisory report although so requested by any such investment company or such security holders if the fairness or feasibility of said plan is in issue in any proceeding pending in any court of competent jurisdiction unless such plan is submitted to the Commission for that purpose by such court.

Sec. 25 (c)—

Any district court of the United States in the State of incorporation of a registered investment company or any such court for the district in which such company maintains its principal place of business is authorized to enjoin the consummation of any plan of reorganization of such registered investment company upon proceedings instituted by the Commission (which is authorized so to proceed upon behalf of security holders of such registered company, or any class thereof); if such court shall determine any such plan to be grossly unfair or to constitute gross misconduct or gross abuse of trust on the part of the officers, directors, or investment advisors of such registered company or other sponsors of such plan.

Sec. 25 (d)—(Printed page 68 Petitioners' Brief).

Sec. 29 (a) and (2), (3)—(Printed page 66 Petitioners' Brief).

Sec. 29 (b)—

Section 44 of said Act of July 1, 1898, as amended, is

amended by adding at the end of subdivision (a) thereof the following sentence:

"If the bankrupt is a face-amount certificate company, as defined in section 4 of the Investment Company Act of 1940, the Court alone shall make the appointment; but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard."

West Virginia Statutes

The following sections of the Code of West Virginia, Ch. ___, Art. ___, Sec. ___:

12-5-1:

Securities Defined.—The term "securities" when used in this article shall include all bonds, securities, debentures, notes or other evidences of indebtedness.

12-5-6:

When Notes Deemed Securities; Appraisal.—(a) Whenever, by statute of this state, any public official, board, commission or department of this state is charged with the approval of securities required as collateral for the deposit of public or other funds, or required to be deposited with the state treasurer, or an investment of capital or surplus or a reserve or other fund is required to be maintained consisting of designated securities deposited with the state treasurer, such securities shall, at the discretion of such public official, board, commission or department, be deemed to include and mean notes executed by the person or corporation required to make such deposit and made payable to the state of West Virginia upon demand, in the event of insolvency or default by such person or corporation, for the benefit of those for whom such securities are deposited, when such notes are secured * * *.

33-1-1:

Insurance Commissioner; Expenses; Assistants.—The auditor of this State shall continue to be the insurance commissioner of this State. * * *

~~33-2-15~~: (Printed page 69 Petitioners' Brief).
33-9-1: (Printed page 70 Petitioners' Brief).
33-9-3: (Printed pages 70-72 Petitioners' Brief).
33-9-10: (Printed page 72 Petitioners' Brief).

Constitutional Provisions Discussed

Constitution of West Virginia:

Article VI, Section 35.—The State of West Virginia shall never be made defendant in any court of law or equity, except the State of West Virginia including any subdivision thereof, or any municipality therein, or any officer, agent, or employee thereof, may be made defendant in any garnishment or attachment proceeding, as garnishee or suggestee.

PART III

DIGEST OF DEPOSITORY LAWS AND TRUST INDENTURES OF THE FIFTEEN STATES WHERE FIDELITY MADE A DEPOSIT AND STATUS OF STATE COURT PROCEEDINGS PENDING THEREIN

Alabama

By order of State Securities Commission, on July 9, 1938, Fidelity securities were admitted to record in the Registry of Qualified Securities, upon compliance with the following terms: To enter into a bond in the amount of $5,000.00 and a trust indenture. The trust indenture was entered into with the First National Bank of Montgomery, Alabama, for a two year period from March 23,

1939, and provided for a deposit and assignment of securities acceptable to the Securities Commission, "to be equal at all times to $110.00 for every $100.00 of liability under its certificates;" and further provided a method for valuing the deposited securities, provided that the deposit should be "in trust for the holders of all contracts issued and to be issued to residents of Alabama, and shall constitute a separate and exclusive trust fund," and shall not be available to general creditors of the investment company; that a full and complete assignment of all right, title and interest in the deposited securities should be made to the depository; and provided that upon a default by the company the securities were to be delivered to the State Securities Commission, upon written demand therefor, to be administered and liquidated for the benefit of Alabama investors; and in no event should the deposit be less than the liabilities of the company upon all contracts and certificates issued to residents of the State of Alabama.

Default was claimed, and the securities were transferred to the Securities Commission, who is holding them and acting under the advice and counsel of the Attorney General pending the outcome of these proceedings.

Delaware

Statutes require the company to obtain a license to do business in the State, and as a condition prerequisite, deposit with the State Banking Commissioner "in trust for the benefit of its contract holders resident in the State of Delaware, approved securities in the amount of $100,000.00," and that the Commissioner, if he shall determine that the deposit is insufficient for the protection of contract holders, having regard for its obligations, may demand forthwith additional securities not in excess of

100% of its obligations to contract holders resident in said State.

The securities have been retained by the Banking Commissioner in Delaware, who is acting under the advice of the Attorney General, pending the determination of these proceedings.

Illinois

Prior to July 7, 1931, there was no depository law in Illinois. On that date legislation was enacted requiring a deposit of not less than $50,000.00 of securities in which life insurance companies could invest, and the deposited fund at no time to be less than issuer's current contract liability on all contracts thereafter sold in the State of Illinois. The State Treasurer holds the deposit as custodian for the Secretary of State. By a later enactment, the Illinois Security Law was amended to provide that the deposit be maintained to cover all contract liability on contracts theretofore or thereafter sold in Illinois, and the Secretary of State is given the right, in the event of insolvency, to liquidate the deposited securities, under the supervision of a court of competent jurisdiction, and the procedural steps to be taken in that regard by the Secretary of State are stated.

The Secretary of State instituted a proceeding in the Circuit Court of Sangamon County, Illinois, under the Illinois Security Act, for the preservation and maintenance of the securities on deposit. The Attorney General of Illinois represents the Secretary of State in those proceedings.

Indiana

Prior to April 1, 1935, when the Legislature repealed it, the law of Indiana required a deposit of approved securities with the Auditor of not less than $25,000.00,

and at all times a sum "equal to the amount of its liabilities to citizens of this State." The benefits of this law were preserved by a trust agreement, and the deposited amount retained in Indiana. There was no depository requirement until April 1, 1939, when the Indiana Securities Commission adopted and promulgated a rule requiring annuity companies to deposit, in trust, with the Auditor, a bank or other approved depository, for the benefit of the holders of such contracts, securities valued at not less than $10,000.00, and at no time less than the amount of the issuer's current contract liability on all outstanding contracts sold in the State.

A receiver was appointed for the assets of the defendant by the Marion Superior Court, in the suit of *Kernel, plaintiff*, v. *Fidelity Assurance Association*, but the bank with whom the assets are deposited in trust has retained possession of the deposited securities pending the outcome of these proceedings, and the Securities Commission of Indiana is being advised by the Attorney General, who is acting in the premises.

Iowa

Statute requires a certificate of authority from Commissioner of Insurance, and as a prerequisite a bond approved by him guaranteeing the faithful performance of all contracts entered into, or deposit of approved securities of $25,000.00, and a deposit equal in amount to all its liabilities to persons residing within said State.

On May 19, 1941, Charles R. Fischer, Insurance Commissioner, was appointed receiver of the assets by the District Court of Polk County, in the case of *Shaw* v. *Fidelity Assurance Association*, and in said action, by order of said Court, title to said securities was vested in said Insurance Commissioner.

Kansas

The State Securities Law required a deposit of $50,000.00 of approved securities in an amount between 100% and 120% of the liability on all outstanding contracts sold and held in said State. The 1929 Legislature of Kansas reenacted the Securities Law, but omitted the provision for making the deposit, and consequently no deposit was made in Kansas for contracts sold subsequent to that date.

Receivership proceedings were instituted in State Court in Kansas by the Attorney General on behalf of the Commissioner of Securities Division of the State Corporation Commission and an ancillary receiver was therein appointed.

Kentucky

In compliance with the requirements of the Securities Department, a deposit was made with the Farmers Deposit Bank of Frankfort, Kentucky, under agreement dated November 5, 1935. The securities deposited were to be held for the Securities Commissioner and were to be in the initial sum of $10,000.00, and in addition such amounts as might be necessary for the specific purpose of maturing and paying the amounts due under the terms of the Income Reserve Contract Series D. By agreement dated November 2, 1938, and with the approval of the Director of the Division of Securities of the State of Kentucky, the agreement was modified so as to provide for deposit of securities to cover the cash liability of the Association on all series of contracts issued by it and held by residents of the State of Kentucky.

Application for appointment of receivers was made in the Circuit Court of Franklin County, in the suit of *Lusk* v. *Fidelity Assurance Association*, no turn over has been made to them, and the Attorney General of Kentucky is acting in the premises.

Missouri

By approval of the Securities Commissioner of Missouri, a deposit was made with the Wheeling Dollar Savings & Trust Company, of Wheeling, West Virginia, for the benefit of holders of contracts of Fidelity residing in Missouri, the deposit to be held for the Securities Commissioner, in an amount equal to 100% of the cash liabilities to Missouri contract holders.

On May 28, 1941, in the cause of "*State ex info. Roy McKittrick, Attorney General, ex rel. Russell Maloney, Commissioner of Securities*, v. *Fidelity Assurance Association*," a receiver was appointed, who later demanded a return of the deposit physically to the State of Missouri, which the District Court granted, where the securities are now being held under order of the Circuit Court of Cole County.

Maryland

The laws of Maryland require companies such as Fidelity to assign to and deposit with the Insurance Commissioner, in trust as security for the holders of contracts sold in Maryland, certain securities of value not less than $25,000.00, and in addition an amount equal to the aggregate contract liability of the company under all contracts theretofore or thereafter sold in the State.

No receiver was appointed in Maryland, but the Circuit Court of Baltimore City, an equity court, in the exercise of its ordinary chancery powers assumed jurisdiction of, and supervision over, the administration of said trust, and the Insurance Commissioner of Maryland, as Trustee, is now subject to the orders of said Court.

Ohio

Prior to April 21, 1939, in Ohio, as a prerequisite to doing business, annuity companies were required to deposit

with the Treasurer $100,000.00 as security for all claims of residents of Ohio against such company for judgments and decrees. Those laws were amended on the above date, so as to require Fidelity to maintain a deposit with the Supervisor of Bond and Investment Companies, of approved securities in an amount equal to the cash surrender value on all contracts thereafter entered into with persons resident in the State. Beginning March 1, 1940, if the company then or thereafter was licensed to do business, it was required to deposit securities to the full cash surrender value of all contracts held by residents of this State, including those issued prior to the effective date of the Act. Fidelity quit doing business in Ohio prior to March 1, 1940, and therefore never became subject to the retroactive provisions of the statute.

On April 17, 1941, John A. Lloyd, Superintendent of Insurance and Supervisor of Bond Investment Companies, was appointed Receiver of the assets of Fidelity situate in Ohio, including the deposited securities, by the Common Pleas Court of Franklin County, Ohio, in his suit against the company, instituted on his behalf by the Attorney General of Ohio.

Pennsylvania

The Pennsylvania Securities Commission must license incoming corporations, and as a prerequisite, a deposit of $100,000.00 as security for the fulfillment of its contracts theretofore or thereafter sold to residents of Pennsylvania.

In the latter part of 1939, an agreement between Fidelity and Pennsylvania Securities Commission was entered into, whereby Fidelity was given a temporary license to do business in the State upon its promise to make a deposit with the Securities Commission of $100,000 as security for the fulfillment of its contracts, sold during

the existence of the temporary license, and a deposit of approximately $132,000.00 was made under said agreement.

On April 17, 1941, receivers were appointed by the United States District Court for the Eastern District of Pennsylvania, in the equity cause entitled *Levy v. Fidelity Assurance Association*, and that Court required the Securities Commissioner in the Middle District of Pennsylvania to make a turn-over to those receivers of the securities deposited with that Commissioner. In June of 1942, this Court, upon request therefor, awarded approximately $11,000.00 to said receivers and their attorneys for their services, principally in retaining those securities in a proper bank vault.

Receivers were appointed in a similar suit instituted in the Western District of Pennsylvania, which receivers have in their possession approximately $32,000.00 of the general undeposited assets of the company. These receivers have agreed with West Virginia officials for a termination of their proceedings.

The Attorney General of Pennsylvania has tentatively agreed to cooperate with West Virginia officials to attempt to have the other Federal equity receivership terminated and the funds returned to the Pennsylvania Securities Commission.

Tennessee

The statute of March 10, 1939, required a deposit with the Commissioner of Insurance and Banking, for the benefit of holders of the contracts in that State, in an amount not less than $10,000.00 and in no event less than 100% of the issuer's cash liability on all outstanding contracts sold in Tennessee.

On April 21, 1941, in the Chancery Court for Davidson County, Tennessee, a general creditors' bill was brought

by *L. H. Brooks et al.* v. *Fidelity Assurance Association*, and the Treasurer of Tennessee, as the legal custodian of the securities deposited therein, was made a party to the cause and directed to retain the securities, and the Court found that the appointment of a receiver was unnecessary, the Attorney General representing the Treasurer therein.

Virginia

In Virginia the Securities Division of the State Corporation Commission required Fidelity to post a bond of $25,000.00 as a condition precedent to doing business in the State, to which those doing business with the company could look, for payment of judgments obtained for fraudulent sales, failure to obey Virginia statutes, and other losses suffered by those who did business with Fidelity. In lieu of a surety on the bond, United States Government securities were deposited with a Richmond bank under a written agreement.

Alex W. Neal, Jr., was appointed receiver in the Circuit Court of the City of Richmond for said company, and has cooperated with the Securities Division. The above bond has expired, and the statute of limitations on claims thereunder will shortly expire, at which time the securities deposited as collateral to the bond will be turned over to the receiver, with the consent and approval of the Securities Division.

West Virginia

Statutes Given in Full in Appendix, Parts I and II.

Wisconsin

Under the laws of Wisconsin for the regulation of foreign building and loan associations, Fidelity was required to keep on deposit with the State Treasurer, in trust for the benefit and security of all its members (contract

holders) in said State, the sum of $500,000.00, to be held in trust until all contracts held by residents of said State had been fully performed and discharged, the securities to be approved by the Banking Commission. Whenever the Banking Commission should find that the liability of the issuer for contracts outstanding for persons residing in the State exceeded 90% of the deposit required above, the Commission may issue an order requiring the deposit of an additional sum, so that at all times the outstanding liabilities shall not exceed 90% of the deposited securities.

On April 14th, the Banking Commission, by the Attorney General of Wisconsin, filed its petition in the Circuit Court of Dane County, Wisconsin, for the purpose of having adjudged and decreed the title, possession and control of the assets, business and property of Fidelity located in Wisconsin to be vested in the Banking Commission; and an order was entered in May liquidating approximately $1,500,000.00 of the deposited securities, and authorizing the Banking Commission to study any plan for reinstatement of the defendant, and, if acceptable, to submit it to the Court for approval.

PART IV

"WEST VIRGINIA SOUND VALUE" FORMULA FOR VALUATION OF DEPOSITED SECURITIES

The Auditor and ex officio Insurance Commissioner of the State of West Virginia has prescribed a formula for the valuation of deposited securities. According to said formula

(1) Bonds and debentures that are not now in default of their interest or principal, and that have continued to pay interest, should be valued at par;

(2) All preferred and common stocks should be valued at the market;

(3) All mortgages, real estate and secured notes should be carried at book value until such time as an appraisal or offer for sale indicates the value to be less, at which time the value for each should be changed to the lesser figure;

(4) All securities that are actually in default of principal or interest, or that have paid principal or interest in the past three years by the sale of additional securities or solely by means of borrowing money for this purpose, without having earnings equal to the amount to offset the loan, should be carried at current market prices.

PART V

LETTER OF AUDITOR EDGAR B. SIMS OF MARCH 25, 1941

STATE OF WEST VIRGINIA
AUDITOR'S OFFICE
CHARLESTON

EDGAR B. SIMS — AUDITOR
INSURANCE COMMISSIONER

INSURANCE DEPARTMENT
HARLAN JUSTICE

March 25, 1941

Mr. Arthur B. Koontz
Attorney-at-Law
Charleston, West Virginia

Dear Sir:

Owing to the precarious condition of the Fidelity Assurance Association, inasmuch as the company has been poorly handled and the capital and surplus would seem to be entirely wiped out and, perhaps, reserves impaired somewhat if absolute market values are applied, I have been giving serious consideration to asking for a receiver

ship in the Circuit Court of Kanawha County as is provided under the special statute under which the company was originally organized.

However, before doing so I should like to explore the possibility of placing this company in trusteeship under 77B of the Federal Bankruptcy Act for the purpose of determining whether this company can be reorganized and put on a sound basis financially and under competent management.

Inasmuch as you have acted for this company in a legal capacity for several years, I would ask you to consider the observations made hereinbefore and advise me at your very earliest convenience what steps we should take in the premises. You, of course, are at liberty to consult the members of the staff of the Attorney General's office or the legal staff of the S. E. C., or both.

Please investigate this matter immediately as I feel that no time should be wasted in reaching a decision.

Very truly yours,

(Signed) EDGAR B. SIMS,
State Auditor,
Insurance Commissioner.

EBS:MB

PART VI

LETTER OF JULIAN F. BOUCHELLE, JUDGE OF THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA, TO BEN MOORE, JUDGE OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA

STATE OF WEST VIRGINIA
THIRTEENTH JUDICIAL CIRCUIT
CHARLESTON

September 19, 1941.

JULIAN F. BOUCHELLE
JUDGE

Honorable Ben Moore, Judge
United States District Court
Charleston, W. Va.

My dear Judge Moore:

I noticed in this morning's Gazette a statement attributed to you questioning the propriety of the appointment of Mr. Ross B. Thomas as co-receiver of the Fidelity Assurance Association by this court. I feel that you should be fully advised as to the circumstances which motivated my action in appointing Mr. Thomas as co-receiver with Mr. H. Isaiah Smith.

When application was made to me for the appointment of receivers under the West Virginia statute, there were present Messrs. W. W. Goldsmith and P. D. Koontz of the firm of Koontz & Koontz, Ira J. Partlow, Assistant Attorney General of West Virginia, and Auditor Edgar B. Sims in person, and upon their presentation of the

facts, and particularly the fact of Mr. Thomas' connection and intimate knowledge of the complicated affairs of the company, (which was later confirmed when I had made further investigation into the case), and with express consent of the auditor and the attorney general's office, I appointed the two above named persons as co-receivers.

Shortly thereafter I called Messrs. W. W. Goldsmith and P. D. Koontz to my office and explained to them that I would not place Mr. Thomas upon a salary as co-receiver, but would allow Mr. H. Isaiah Smith a monthly salary of $500.00 as receiver, and the firm of Koontz & Koontz a like sum as counsel for the receiver. I felt that upon the information given me and the knowledge I obtained that no one was better qualified to advise and act with Mr. Smith as receiver than Mr. Thomas. I indicated plainly to Messrs. Goldsmith and Koontz that this situation would continue only during the period of attempted reorganization, and which period I insisted should not be long-drawn out; and that if reorganization was found impossible and the time of liquidation reached, that I would give recognition to the representatives of the contract holders in the matter of receivership from that point on, and that Mr. Thomas would not be retained.

Counsel of this city representing some of the contract holders had conferences with me during the time the case was in this court, and I advised them of the foregoing and assured them that not only would they be notified but that they would be fully advised with upon the matter of reorganization; and that if and when the case became one of liquidation, I would give favorable consideration to recommendations by a substantial number of the contract holders in the receivership.

I feel that this explanation is due in fairness to Mr. Thomas and the firm of Koontz & Koontz, and, as pre-

viously stated, to acquaint you with my actions and intentions in this case.

Very truly yours,

JFB:SB (Signed) J. F. BOUCHELLE.

CC: Honorable Clarence W. Meadows
Honorable Edgar B. Sims
Messrs. Koontz & Koontz, Attorneys.

PART VII

SAMPLES OF UNIFORM PROOFS OF CLAIM AND LETTER OF TRANSMITTAL TO CONTRACT HOLDERS, TENTATIVELY AGREED TO BY DEPOSITORY STATES, AND ALREADY USED BY WEST VIRGINIA AND MISSOURI

H. ISAIAH SMITH and ROSS B. THOMAS, Receivers for FIDELITY ASSURANCE ASSOCIATION and Agents of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of West Virginia

FIDELITY BUILDING
WHEELING, W. VA.

The matter of Fidelity Assurance Association is now pending on an appeal to the Supreme Court of the United States. The United States Circuit Court of Appeals for the Fourth Judicial Circuit, on June 16, 1942, reversed the lower court and held that the reorganization proceeding pending therein should be dismissed. The appeal will determine whether the matter will be proceeded with in Federal Court or whether liquidation will ensue under the supervision and control of the various state officials who have under their authority and control the assets deposited in their state.

Pending the appeal, the Fourth Circuit Court of Appeals, by order of July 22, 1942, has permitted each proper state official or state court, having jurisdiction to make plans for future distribution of the funds under their control, supervision or jurisdiction. It is therefore necessary to ascertain the claims against the company, and the claims against each state deposit. Should it finally be held that the Federal Court has sole jurisdiction of the proceedings, all proofs of claim received will be turned over to the proper officials thereof.

Your contract account is set out below as shown by the company's books, as of April 11, 1941, the date of receivership. Enclosed is a proof of claim which must be completed by you and sworn to before a Notary Public, whose seal must be used, and returned in the enclosed envelope. If the figures are incorrect in any particular, insert

the correct figures, stating in writing your reasons therefor. *Payments received from you after April 4, 1941, are kept in a separate escrow fund, of which you have previously received notice.*

Serial No. , upon which

monthly payments of $ each have been made;

on which the cash surrender value as of April 11, 1941 was $

less contract loan and accrued interest to April 11, 1941 of $

or a net cash value as of April 11, 1941 of $

Your contract must accompany your return of claim. It is suggested you use registered mail with return receipt requested. This return must be filed before , 1942 and is being sent under order of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia.

Very truly yours,

H. ISAIAH SMITH and ROSS B. THOMAS.
Receivers and Agents

[18]This is the uniform form of the letter of transmittal sent by State officials and receivers to the contract holders. All of the blank spaces are typed in before the letter is mailed.

IN RE: FIDELITY ASSURANCE ASSOCIATION
(formerly Fidelity Investment Association)[19]

PROOF OF CLAIM OF

Filed with H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, as such, and as agents of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia, against said Company generally, pursuant to a proper and lawful administrative order of the said Edgar B. Sims, Auditor and ex-officio Insurance Commissioner, issued on the 17th day of August, 1942.

STATE OF)
COUNTY OF)

Personally appeared before me, the undersigned authority, who, being by me first duly sworn, according to law, did depose and say that he is the owner of the contract hereinafter referred to, issued by Fidelity Investment Association, a West Virginia corporation; that he purchased said contract on the day of , 19 , in the State of , and that on the 11th day

of April, 1941, he was a resident of the State of ; that said Company is truly and justly indebted to him in accordance with the terms of said contract, the same being identified as

Serial No. , upon which

monthly payments of $ each have been made for application in accordance with the terms thereof, exclusive of payments made to the Company, its Receivers or Trustee subsequent to April 4, 1941, held by it or them in escrow subject to his order, of which he has heretofore been advised; that the cash surrender value thereof is $

less contract loan and accrued interest of $

or $

and that attached hereto and made a part hereof is the original contract above referred to.

(signature)

Taken, subscribed and sworn to before me this day of , 19
My commission expires on the day of , 19

(Notarial Seal) Notary Public

SEPARATE PROOF OF CLAIM MUST BE MADE IN RESPECT OF EACH CONTRACT HELD

[14] This is the uniform proof of claim form agreed upon, and the one used by the West Virginia respondents. All blank spaces but the place of residence of the contract holder when he purchased his contract, his signature with verification were filled in before mailing.

IN RE: FIDELITY ASSURANCE ASSOCIATION
(formerly Fidelity Investment Association)[15]

PROOF OF CLAIM OF

Filed with against said Company generally, and particularly against the assets thereof in the State of , pursuant to an order of , the of , dated the day of , 1942.

STATE OF)
COUNTY OF)

, Personally appeared before me, the undersigned authority, , who being by me first duly sworn according to law, did depose and say that he is the owner of the contract hereinafter referred to, issued by Fidelity Investment Association, a West Virginia corporation, that he purchased said con-

tract on the ..... day of ....., 19..., in the State of.....
..... and that on the 11th day of April, 1941, he was a resident of the State of.....; that said Company is truly and justly indebted to him in accordance with the terms of said contract, the same being identified as Serial No.....upon which an initial payment and .....monthly payments of $..... each have been made for application in accordance with the terms thereof, exclusive of payments made to the Company, its Receivers or Trustee subsequent to April 4, 1941, held by it or them in escrow subject to his order, of which he has heretofore been advised;
that the cash surrender value thereof is $.....

less contract loan and accrued interest of $.....

or $.....

and that attached hereto and made a part hereof is the original contract above referred to.

.....
(signature)

Taken, subscribed and sworn to before me this ..... day of ....., 19....
My commission expires on the ..... day of ....., 19....

.....
(NOTARIAL SEAL) Notary Public

SEPARATE PROOF OF CLAIM MUST BE MADE IN RESPECT OF EACH CONTRACT HELD

[18]This is the uniform proof of claim form used by States other than West Virginia. Again, all data is supplied before mailing. This claim will be filed by each State in its own proceedings.

IN RE: FIDELITY ASSURANCE ASSOCIATION
(formerly Fidelity Investment Association)[18]

PROOF OF CLAIM OF

.....

.....

.....

Filed with H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, as such, and as agents of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia, against said Company generally, pursuant to a proper and lawful administrative order of the said Edgar B. Sims, Auditor and ex-officio Insurance Commissioner, issued on the 17th day of August, 1942.

STATE OF _____)

COUNTY OF _____)

Personally appeared before me, the undersigned authority, _____, who, being by me first duly sworn according to law, did depose and say that he is the owner of the contract hereinafter referred to, issued by Fidelity Investment Association, a West Virginia Corporation; that he purchased said contract on the _____ day of _____ 19__, in the State of _____, and that on the 11th day of April, 1941, he was a resident of the State of _____; and that said Company is truly and justly indebted to him in accordance with the terms of said contract, the same being identified as

Serial No. _____, upon which an initial payment and _____ monthly payments of $_____ each have been made for application in accordance with the terms thereof, exclusive of payments made to the Company, its Receivers or Trustee subsequent to April 4, 1941, held by it or them in escrow subject to his order, of which he has heretofore been advised;

that the cash surender value thereof is $_____

less contract loan and accrued interest of $_____

or $_____

_____
(signature)

Taken, subscribed and sworn to before me this _____ day of _____, 19__.

My commission expires on the _____ day of _____, 19__.

(NOTARIAL SEAL)

_____
Notary Public

SEPARATE PROOF OF CLAIM MUST BE MADE IN RESPECT OF EACH CONTRACT HELD

[18]This form, in a separate color, is also sent out by the States other than West Virginia, with the data filled in. It is returned to the State official sending it out. In the event there is later to be a claim over against the West Virginia funds, these claims will be sent en masse to West Virginia by the State official who receives them.

PART VIII

EXCERPTS FROM EXHIBIT 6, REPORT OF S. E. C. TO CONGRESS CONCERNING FACE-AMOUNT CERTIFICATE COMPANIES

Chapter III, Fidelity Assurance Association:

Page 88:

"For the period from 1927 to 1936 installment payments by certificate holders aggregated $49,230,000, of

which the Association applied on its books as income a total of $12,427,000, or 25.2%—25.2 cents of every $1 of installment payments. * * * Total commissions paid during the period 1927-1936 amounted to $9,308,000, a sum equal to 18.9% of total installment payments."

Page 96-7:

"The Association has followed a settled policy of investing its funds almost entirely in marketable securities, about 90% of which have consisted of bonds and notes. Investments in stocks have consisted principally of preferred stocks and have been, in the main, too small in amount to be of any importance. * * *

TABLE 26.—Classification of assets of Fidelity Investment Association, 1927-36 year-ends

(Amounts in thousands of dollars)

Year	Cash	Bonds and Stocks*	Certificate Loans	Other Loans†	Real Estate	Other Assets	Total
1927	217	11,851	2,369	206	66	----	14,799
1928	258	13,914	2,632	215	66	----	17,085
1929	258	14,595	4,360	417	62	59	20,151
1930	1,014	16,586	6,903	406	50	88	25,047
1931	770	18,373	8,918	896	50	129	29,136
1932	933	16,729	6,162	1,160	152	149	25,285
1933	547	18,331	3,951	1,130	152	174	24,285
1934	375	19,448	2,733	1,193	166	251	24,166
1935	789	21,838	2,548	1,033	264	306	26,778
1936	1,062	25,791	2,308	919	272	596	30,948
			Percent of Total				
1927	1.5	80.0	16.0	2.0	0.5	----	100.00
1928	1.5	81.4	15.4	1.3	.4	----	100.00
1929	1.3	74.4	21.6	2.1	.3	0.3	100.00
1930	4.0	66.2	27.6	1.6	.2	.4	100.00
1931	2.6	63.1	30.6	3.1	.2	.4	100.00
1932	3.7	66.2	24.4	4.5	.6	.6	100.00
1933	2.3	75.5	16.3	4.6	.6	.7	100.00
1934	1.6	80.5	11.3	4.9	.7	1.0	100.00
1935	3.0	81.6	9.5	3.9	.9	1.1	100.00
1936	3.4	83.3	7.5	3.0	.9	1.9	100.00

*Stocks generally were around 10 percent of the total.

†These consist of collateral and mortgage loans; also year-end balances of advances to National Sales Agency: 1927, $135,000; 1928, $140,000; 1929, $344,138; 1930, $538,000; 1931, $830,648; 1932, $982,179; 1933, $957,979; 1934, $1,048,402; 1935, $927,839; and 1936, $858,918."

Page 100:

"The Association apparently is able to continue in business and make a profit by appropriating to income a large part of the installment payments in the early months after the issuance of the certificates. * * *"

"For the period 1927-1937, net realized profits from the sale of investments aggregated $740,000 or about 50% of the total profits for the period."

Page 106:

"The experience of purchasers of the Association's investment certificates appears to have been unsatisfac-

tory, as a whole * * * But the group of certificate holders whose certificates lapsed or were surrendered before maturity—and this group constituted a large majority of all holders of terminated certificates—*suffered substantial losses*, both of capital and interest increment."

Pages 110-111:

"In other words—considering all certificates outstanding at any time during the period 1927-1936, and taking them by years—*from 91.38% to 93.14% of all terminations represented lapses or premature surrenders, leaving only from 6.86% to 8.62% of total terminations to be accounted for by terminations as the result of normal maturity.*"

Page 113:

"TABLE 29.—Comparative experience over a period of 10 years of an Income Reserve Contract, Series B certificate holder of Fidelity Investment Association and the holder of a United States Savings Bond.

Year	Annual investments or installment payments (cumulative)	Comparative cumulative cash values at year-ends		Excess of United States Savings Bonds over Fidelity Investment Association Certificates	Percent advantage over cumulative cash value of Fidelity's Certificates
		United States Savings Bonds	Fidelity Investment Certificates		
First	$ 100	$ 101.33	$ 35.66	$65.67	184.2
Second	200	205.33	137.49	67.84	49.3
Third	300	312.00	243.10	68.90	28.3
Fourth	400	421.33	352.50	68.83	19.5
Fifth	500	533.33	467.41	65.92	14.1
Sixth	600	648.00	586.07	61.93	10.6
Seventh	700	765.33	710.11	55.22	7.8
Eighth	800	888.00	841.29	46.71	5.6
Ninth	900	1,016.00	984.75	31.25	3.2
Tenth	1,000	1,149.33	1,145.68	3.65	.3

Page 119:

"The costs for the period (1927-1936) was 31.2 cents for each $1 paid to or preserved for certificate holders, * * *."

Page 184:

"Q. Of course, in any state, provisions like Blue Sky Acts would apply to corporations, no matter what their business, wouldn't they?

"A. That may be true, but I believe in the case of an investment company they usually exercise them more than they would over an ordinary business corporation.

Testimony of E. E. Crabb, Vice Pres., (Investor's Syndicate) before S. E. C., at public examination."

Page 193:

Deposits by Investors Syndicate December 31, 1937

State	Amount of deposit*	Cash value of certificates outstanding
Alabama	$2,574,359.48	$2,206,996.96
California	5,266,212.34	4,659,471.50
Colorado	25,066.47	1,699,142.45
Connecticut	3,655,947.62	3,043,956.81
Florida	147,068.86	1,042,579.06
Georgia	1,592,955.18	1,378,212.25
Illinois	1,175,394.19	1,355,142.83
Iowa	2,585,940.26	2,035,911.58
Kansas	4,649,612.98	4,373,613.31
Louisiana	551,234.44	463,249.06
Maryland	917,982.76	747,359.31
Massachusetts	2,965,302.19	2,635,390.83
Minnesota	125,260.27	7,856,240.32
Missouri	2,990,627.94	2,595,458.01
Nebraska	119,220.17	162,844.19
Nevada	25,107.02	102,108.36
New Jersey	30,079.76	1,469,928.48
New York	4,357,675.58	4,039,017.08
North Carolina	1,660,281.26	1,427,228.51
North Dakota	1,785,129.00	1,579,933.90
Ohio	100,265.87	206,489.28
Oregon	691,454.96	581,782.38
Pennsylvania	100,265.87	1,918,522.08
South Dakota	2,089,240.97	1,766,230.48
Tennessee	2,743,769.41	2,484,382.19
Texas	1,227,868.70	2,053,735.56
Utah	1,296,022.42	1,097,808.80
Virginia	100,363.28	1,717,084.50
Washington	983,690.57	865,738.88
West Virginia	1,674,893.48	1,480,497.15
Wyoming	60,755.07	258,030.42
TOTAL	$48,269,048.37	$59,291,086.52

*Securities at book values.

BREAKDOWN OF TABLE C; STATEMENT SHOWING LOCATION OF CONTRACT HOLDERS AND ASSETS GEOGRAPHICALLY AND IN PERCENTAGES

DEPOSITORY STATES

States Which Apparently Cannot and Probably Will Not Have Claim Against West Virginia Deposit

	1(a)	2(b)	3(c)	4(b)	5(d)	6(b)	7(e)
Iowa	54		34,478 27		45,082 50		130
Wisconsin	6,595		2,342,978 73		2,619,399 07		111
Missouri	1,722		786,988 86		861,100 62		109
Alabama	81		31,346 71		32,555 16		103
Delaware	582		290,175 36		293,790 63		101
Tennessee	567		200,504 97		196,574 38		98
Maryland	1,152		492,552 24		470,806 25		95
Kentucky	328		92,690 42		86,712 50		93
Illinois	8,051		4,225,790 75		3,759,844 00		89
TOTAL 9 States	19,132	38 3%	8,497,506 31	36 2%	8,365,915 11	41 7%	

States With Probable Claim Over Against West Virginia Deposit

Kansas	254		108,784 89		83,337 50		76
Indiana	846		386,173 45		162,863 44		42
Ohio	6,059		2,360,418 70		509,573 44		21
Virginia	1,406		557,809 19		27,703 13		5
Pennsylvania	8,794		4,668,582 25		232,591 57		5
Total 5 States	17,359	34 4%	8,081,768 48	34 4%	1,016,069 08	5 1%	

(a) No. of contracts having reserve value or monthly payments being paid currently on 4/4/41.
(b) Percentage of total.
(c) Net cash liability April 10, 1941.
(d) Securities deposited market value June 6, 1941.
(e) Percentage of market value to cash liability.

NON-DEPOSITORY STATES

States With Less Than 100 Contracts

	1(a)	2(b)	3(c)	4(b)
Arizona	24		10,191 82	
Arkansas	16		8,221 58	
Colorado	25		17,909 03	
Idaho	2		1,263 00	
Maine	6		2,484 50	
Massachusetts	98		80,590 64	
Mississippi	21		8,335 24	
Montana	4		5,111 50	
Nebraska	24		7,661 27	
Nevada	1		312 50	
New Hampshire	9		9,151 84	
New Mexico	11		9,371 06	
North Dakota	9		36,487 35	
Oklahoma	97		105,815 64	
Oregon	8		4,137 24	
Rhode Island	10		6,647 71	
South Dakota	11		6,785 12	
Texas	89		37,529 08	
Utah	3		1,944 00	
Vermont	6		3,564 50	
Washington	41		34,650 60	
Wyoming	6		5,679 79	
Total 22 States	521	1%	404,145 01	1 7%

States With Between 100 and 500 Contracts

California	228		169,577 35	
Connecticut	175		116,276 09	
Florida	119		97,946 02	
Foreign Countries	107		72,811 33	
Georgia	254		159,164 28	
Louisiana	301		40,941 77	
Minnesota	284		176,837 14	
North Carolina	117		80,592 13	
South Carolina	256		41,130 62	
Total 9 States	1,841	3 6%	955,276 73	4 1%

States With Over 500 Contracts

District of Columbia	1,658		952,502 25	
Michigan	3,158		1,447,607 32	
New Jersey	526		285,356 15	
New York	1,019		669,824 67	
Total 4 States	6,401	12 9%	3,355,290 39	14 3%
Total 35 States	8,763	17.5%	4,714,712 13	20 1%